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Understanding Property Insurance in Captives: Inception to Implementation

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Objectives

- Challenges in the commercial market
- Strategic advantages of captive structures, considerations and costs
- Actuarial methodology for pricing property in captives
- Use of fronting carriers: Considerations, costs, and more

State of the Property Market

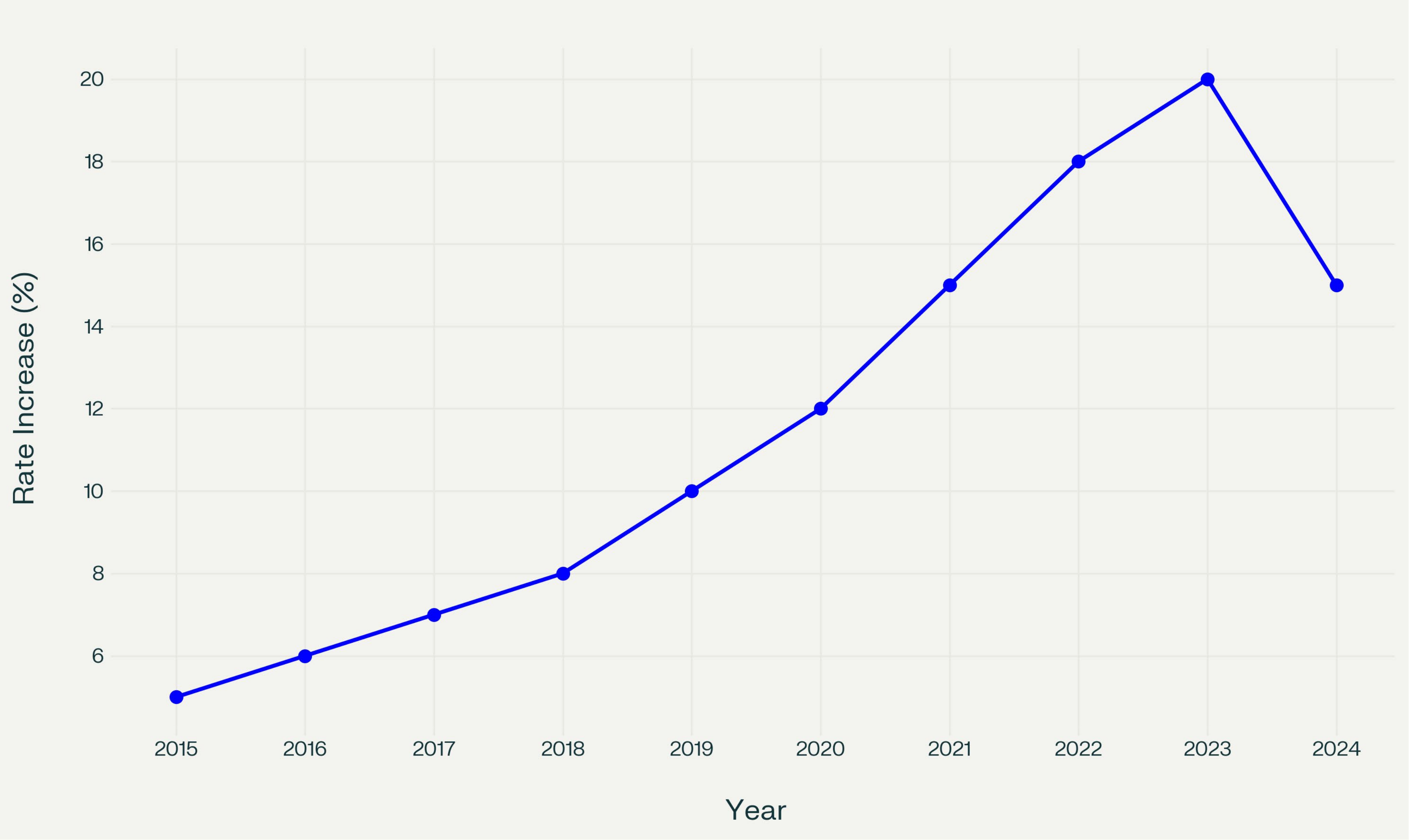
- Property Insurance Trends
  - 73% Average commercial rate increase in Hurricane Zones
  - 40% Reduction in admitted carriers writing coastal risks
- Global NATCAT events and industry-wide poor pricing and underwriting have caused property related coverages to have some of the largest premium increases in recent history.
- Many carriers have restricted appetite, reduced capacity, forced higher retentions, and exited some markets entirely. Recent severe loss events and uncertainty surrounding climate change indicate premiums will likely continue to rise for the foreseeable future.

State of the Property Market

- Property Insurance Trends
  - 2015-2018: Rate increases modest, rising gradually from 5% to 8% per year
  - 2019-2021: Increases accelerated, reaching double digits (10% in 2019, 12% in 2020, and 15% in 2021)
  - 2022-2023: Market experienced relatively aggressive increases, peaking at 18% in 2022 and 20% in 2023 – *The highest average premium increase in over two decades, driven by NATCAT events, inflation, and reinsurance constraints
  - 2024: Average rate increases, and in some cases decreases

Market Drivers

- Catastrophic Weather Events
  - Frequency and severity of natural disasters, particularly in 2022 and 2023, significantly impacted rates
- Inflation
  - Rising costs for building materials and labor, especially in 2021-2023
- Reinsurance Costs
  - Increased reinsurance costs and capacity constraints put further upward pressure on primary insurance rates


Rate Increase (%)
20
18
16
14
12
10
8
6
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
Year

Geographic Risk Hotspots

- Top 5 Vulnerable Regions (ISO 31000 Risk Scores)
  - Florida Coastal – (9.7/10)
  - California Wildfire (8.9/10)
  - Texas Hail Corridor (7.4/10)

Historical Methods to Modify Premium

- Insureds have had very few methods to influence the premiums of their property policies. Often limited to the following:
  - Raising deductibles/insured retentions (if lenders allow)
  - Purchasing less limits
  - Limit coverages being purchased (e.g. exclude flood, EQ, BI)
  - Declared values of properties (underinsure/coinsurance)

Property Challenges

- Even the largest companies in the world must adhere to both regulatory requirements, and contractual requirements that govern lender/vendor agreements. These contracts often contain insurance requirements that would prohibit a captive from writing coverage directly to an insured business.
  - Insurance carrier AM Best Rating & financial size
  - Maximum deductibles/insured retentions
  - Minimum limits

Property Challenges

- Premium: Limit
- Capitalization/Collateralization
- Catastrophic claims potential (severity vs frequency)
- Limited historical claims data
    - Tendency to overact (if there are none and if there is a severe claim)
- Reinsurance
- Catastrophe modeling data
- Geographic concentration (TIV by location/building/city)
- Deductibles – Wind only vs other
- Industry benchmarks (compared to WC or casualty)

Property Opportunities

- Wildfire-prone and windstorm/flood-prone (evolving areas)
  - Severely exposed areas/properties
- Tenants (liability & personal property)
- Homeowners Associations (HOAs)
- Builders Risk
- High wealth individuals (Ability/willingness to retain risk)
- Safe conscious insureds facing large increases & claims free

Potential Property Captive Structures

- Deductible Reimbursement Policies (DRP)
- Fronted Captives – Collateral Considerations
- Property only single parent captives
- Add to existing WC/Casualty single parent captives
- Group Captives (not traditional A/B structure)
- Increase retained captive coverage limits over time
- Fully funded/deposit accounting

Potential Property Captive Structures

- Direct Issued Policies
  - Captive as front/access to reinsurance
    - Pass Throughs
  - Parental guarantees above limits
  - Parametric Coverage
  - Retrospective rating options

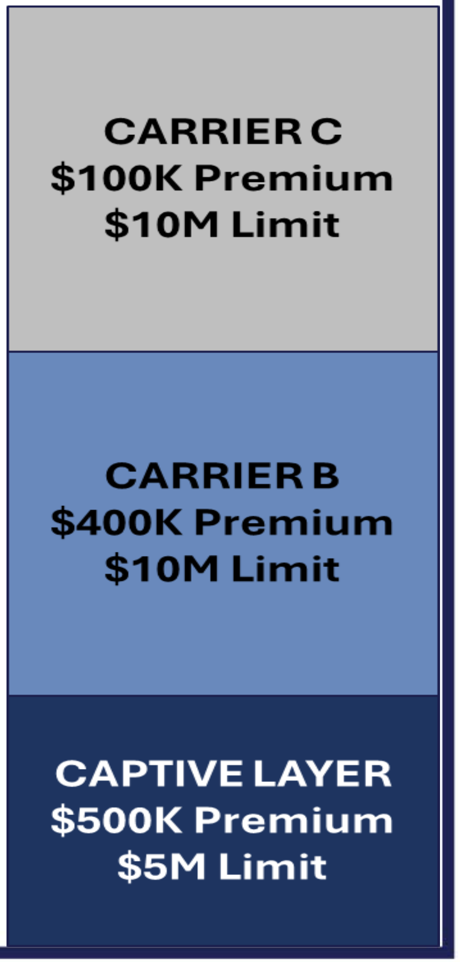
Property Captive Structure vs Commercial Coverage

- Historically businesses were able to purchase a single policy that would provide coverage for the full value of their entire property portfolio. Due to the current restriction within the insurance market, these policies are becoming almost non-existent.
  - Capacity restrictions have limited the amount of coverage being offered
  - Typically for smaller insureds
  - Many businesses paid for coverage that they don’t need

Portfolio Value: $300M	CARRIER A- 100% $1M Premium $300M Limit
Largest Location: $10M	
Total Premium: $1M	
No. of Carriers: 1	

Property Policy Structure Comparison

- Large businesses historically only purchase the coverage that they need. These programs split the premium and coverage between multiple carriers, allowing insured businesses to obtain the coverage they need when markets limit capacity or portfolio gets too large for a single carrier.
  - Can require a sophisticated broker
  - Allows for captive participation within the desired layer
  - Business purchases insurance in the same manner as fortune 500 companies



Actuarial Pricing Approaches

- Increased use of exposure rating techniques
  - Expiring premiums
  - Industry rate filings (e.g., ISO loss costs)
  - Industry deductible filings (ISO)
  - Industry size of loss data (e.g. Lloyds property curves)
  - Industry cause of loss data (ISO)
  - Cat Model Output
- Experience Modification Factors
  - Compare historical losses to expected losses
  - Consider credibility of the data
- Reasonableness Checks
  - Loss rate by layer

Property Captive Case Study

- This insured develops both commercial & multifamily real estate projects throughout the United States with a focus on affordable multi-family housing. They are a vertically integrated company with acquisitions, development, compliance, and asset management divisions. They use their extensive experience to identify and respond to development and acquisition opportunities at strategic points throughout the real estate cycle. Their team has more than three decades of experience as award-winning developers of projects and has been listed on the prestigious inc. 5000 list of America's fastest-growing privately help companies.

Insurance History

- Affordable and market rate apartments located primarily in TX
- Current Total Insured Value ~$200m
- Lenders limited maximum deductibles as low as $25k AOP
- Property premium increases far outpacing additional values (more than doubled over the last 5 years)
- No/low historical claims activity
- Insured has strong balance sheet and desire to take significant risk

Captive Process

- Broker inquiry/conceptual education
- Determine risk tolerance
  - Had AIR and CAT studies completed to determine probably maximum loss
    - Flood
    - Convective storm
    - Named Storm
- Lender negotiations
- Primary and excess market negotiations/policy pricing
- Binding and captive formation

Captive Solution

- Formed an incorporated cell captive
- Captive reinsures an A+ XV carrier with policies issued on an admitted basis
  - Primary $5m per occurrence of property risk
  - Primary $1m/$2m general liability
  - Primary $5m builders risk (post-binding)
- Leverages captive utilization wherever possible for their-part negotiations

Property Captive Case Study

- This Florida-based residential affordable real estate client purchases and manages mobile home parks across the united states. They are known for creating and preserving multi- and single-family affordable housing. They also manage properties in Florida and across the United States.

Insurance History

- Affordable mobile home housing primarily located in FL
- Current Total Insured Value ~$1bn and over 14,000 units
- Lenders limited maximum deductibles as low as $25k AOP
- Property premium increases far outpacing additional values (more than doubled over the last 5 years)
- No/low historical claims activity - ~4%
- Insured has strong balance sheet and desire to take significant risk

Captive Process

- Broker inquiry/conceptual education
- Determine risk tolerance
  - Had AIR and CAT studies completed to determine probably maximum loss
    - Flood
    - Convective storm
    - Named Storm
- Lender negotiations
- Primary and excess market negotiations/policy pricing
- Binding and captive formation

Captive Solution

- Formed an incorporated cell captive
- Captive reinsures an A+ XV carrier with policies issued on an admitted basis
  - Primary $60m per occurrence of property risk
  - Excess $15m/$15m general liability
- Leverages captive utilization wherever possible for their-part negotiations

Qualifying Portfolio Characteristics

- Premium size
- Low loss ratios
- Demonstrated ability/desire to control risk
- High risk tolerance
- Willingness/ability to view premiums as prefunding for future losses and underwriting profit
- Financial ability to pay premiums, post applicable collateral/capital

Thank you!
Questions?

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