



Cayman  
Captive Forum 2011

# PREPARING YOUR CAPTIVE FOR A HARD MARKET

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# Preparing for a Hard Market

## Market Cycles and How to Interpret Them



## Insurance Market Cycle

- May over correct
- Risk selection rejects risks / industry
- Major global events (e.g., hurricanes, earthquakes, tsunamis, flooding, terrorism events)

### Hard Market (Expensive)

- Strong profits
- Capital flows into market
- Price falls
- Expansion of financial markets positively impacts investment income returns

### Sellers Market

- Capital and capacity withdrawn
- Profit demand increase
- Insurers realize losses - prices rise tentatively
- Contraction of financial markets negatively impacts investment income returns

### Soft Market (Cheap)

### Buyers Market

- Increase demand / premium growth
- No significant events
- Influx of new carriers increases supply
- Prices decrease at an increasing rate



# A HISTORY LESSON IN HARD MARKETS

- First PIAA carrier established in 1976 and claims made coverage became an option
- Capacity was restricted - insured quota shared with reinsurers
- New markets developed to assist in restricted capacity (e.g., XL and Ace)
- Funding analysis were important
- Confidence levels were part of underwriting criteria
- Numerous carriers failed (e.g., PHICO, Transit Casualty, Reliance, H.S. Weavers and St. Paul Fire & Marine)



# HOW TO DEFINE MARKET CYCLES

- The 2009 industry Combined Loss Ratio was 82.9, according to A.M. Best, or 85, according to Conning.\*
- The combined loss ratio for the last quarter of 2010 was 87.\* It is projected to rise to 91 for 2011 and to 99 for 2012.\*
- Today the industry is \$120 to \$150 billion over capitalized with a premium surplus ratio of 1:0
- Until there is more pain in the industry, the market will continue to stay soft (after 7 years of rate erosion, the natural disasters in New Zealand, Australia and Japan were not enough to sway the market into a hard one).\*\*

\*Information obtained from the 4<sup>th</sup> quarter 2010 Conning Report and A.M. Best's 2010 Special Report on the Medical Professional Liability Market

\*\* Information obtained from ACE Medical Risk



# HARD MARKET CONDITIONS

Past hard markets have presented opportunities for insurers and reinsurers:

- Attractive environment for new carriers to enter the market (note: new carriers entered this soft market which is unusual)
- Charging for fronts, no risk transfer
- Quota share arrangements
- Extreme terms and conditions



# IMPACT OF A HARD MARKET

- Capacity will shrink
- Terms, such as batch wording protection, will either no longer be provided or a significant charge will be applied
- Leniency in terms of the financial strength of your captive will no longer be granted
- There may be immediate and drastic increases for accounts rated below loss cost
- Broker commissions may be reduced



# HOW TO RESPOND IN A HARD MARKET

Advice from Ace, Endurance, CNA, Zurich, Munich Re, Trans Atlantic Re and Towers Watson:

- Prepare for a hard market in a soft market by establishing and maintaining relationships
- Increase your capital in your captive (do not release reserves until it makes sense)
- Retain more risk
- Pay attention to those reinsurers on your program; evaluate surplus, combined loss ratios (accident year and calendar year) and balance sheets



# IMPACT OF A SOFT MARKET

- Premiums are decreased below loss cost levels
- Opportunities for new coverages can be introduced to your program
- Program Structure philosophy dictates it is often advantageous to buy down your retentions in a soft market
- Make sure you have coverage continuity in any quota share, excess or loss syndicated program
  - Definition of claim
  - Expense cost allocation
  - Batch wording
- Should you reduce funding levels based on untried tort reform?



# WHERE ARE WE NOW IN THE MARKET CYCLE?

Are carriers...

- Are carriers retaining more net capacity because of excellent results or is it that reinsurance costs are prohibitively expensive?
- More carriers are retaining more risk and their net retentions have increased greatly. Are they underwriting for this risk?



# WHERE ARE WE NOW IN THE MARKET CYCLE?

- If you are a new market is there reinsurance available? Most reinsurers say they typically do not support new markets unless they are familiar with the lead underwriter
- Are the markets reporting top line growth as opposed to net growth or profitable growth?
- Should new markets focus on top line growth and existing markets focus on profit ratios and growth? Would their books shrink if they took that direction?



# NEXT STEPS.....

- Pay attention to the investment philosophy of your reinsurer(s)
- Have a discussion on reserve redundancies and surplus levels maintained by your reinsurer
- Look at your program structure carefully
- Be prepared to retain risk or carve out coverages if the market turns hard



# Preparing Your Healthcare Captive For a Hard Market

## HOW TO EDUCATE YOUR LEADERSHIP



# Educating Leadership **During** Before a Hard Market

When should you begin the education process?

## **Don't wait until it happens !!**

- Consider sending monthly or quarterly Risk Management reports to executive management; operations leadership, medical leadership; finance
- Provide an overview of claims; trends – good or bad; market; other issues
- Do not be afraid of delivering bad news
- **NO SURPRISES** - Let leadership know what is going on in the market:
  - Capacity
  - Pricing



# Educating Leadership Before and During a Hard Market

- Provide an annual review, much like a Stewardship Report and present to all members of the leadership team
  - Include:
    - ✓ Claim Review – especially noting new claims, claims of concern; upcoming trials or mediations
    - ✓ Market Overview
    - ✓ Captive Financial Review
    - ✓ Actuarial Updates as available; claim trends
    - ✓ Accomplishments during the year
    - ✓ Issues during the year; resolved and how; those still in process of resolution



# Educating Leadership Before and During a Hard Market

- Maintain a close working relationship and dialog with the CFO. Understanding the financial goals of the company will allow you to present options that dovetail with those goals.
- No surprises!! *(Did I already say that!!)*
- A hard market is a time for Risk Management to demonstrate creative thinking, technical expertise and the ability to put those skills to work to benefit the organization.
- Be sure all stakeholders are involved in the process



# Educating Leadership Before and During a Hard Market

- "Data is critical in all market cycles; in a hard market it is "Critical Plus".....
- From good data comes good information! Prepare exhibits; charts; graphs to demonstrate financial opportunities and the strategies to capture those opportunities
- Work closely with your broker; actuary; and internal resources to finalize those strategies
- Assist in the preparation of market submissions
- Don't under estimate long term market relationships



# Educating Leadership Before and During a Hard Market

- Be prepared to discuss options with your leadership and captive board before market meetings begin
  - ✓ New coverage in the captive
  - ✓ Purchasing higher deductibles in the commercial market and...
  - ✓ Funding those deductibles in the captive
  - ✓ Estimated financial impact of options compared to the current and historical programs in place during the “soft” market



# Preparing Your Captive for the Hard Market

## TECHNICALLY PREPARING YOUR CAPTIVE FOR A MARKET TURN



# Preparing Your Captive for the Hard Market

## Program Structure Issues

- Syndicated Program
- Multiple Lead Options
- Internal Competition
- Don't increase deductible outside of comfort zone while market is trending downward
- Management of Capacity



# Preparing Your Captive for the Hard Market

## Carrier Issues

- Select Reinsurance Partners Carefully
  - Financial Strength and philosophy of carriers
  - History/Longevity
  - Net Capacity
  - Coverages available
  - Control and defense issues
  - Risk management issues
  - Flexibility and creativity
- Maintain strong relationships
  - Carrier visits in soft market can prepare way for hard market
  - Develop additional relationships when possible (may someday need additional capacity)
- Maximize policy enhancements in the soft market
- Continually emphasize positive risk profile



# Preparing Your Captive for the Hard Market

## Captive Issues

- Work with actuary to develop funding levels using alternative retentions
  - Initial meeting to discuss organizational changes and goals with the current market
  - Review history of retentions and losses
  - Discuss retention options and funding requirements
  - Analyze loss histories
  - Identify opportunities
- Build captive surplus to increase internal capacity for additional risk assumption
- Financial Stress Testing of Captive
- Prepare/Educate Captive Board
  - Changing market conditions
  - Possible additional assumption of risk (higher retentions, unavailability of reinsurance, etc.)
- Possible reduction in limits due to hard market conditions



# Strategy in a Hard Market

## AFTER RENEWAL



# After Renewal

Program In Place .....

Time to Review and Still Work to be Done!

- How well did your strategies work for implementing program and structure
- Were you able to utilize the captive for all the options selected?
  - New Coverage
  - Enhanced Coverage
  - Deductibles
- How does the new structure affect your premium allocations? Are you prepared to discuss and explain?



# After Renewal

- How do you communicate new program structure internally? Who really needs to know?
- Have you met with your leadership and financial folks to be sure they understand the impact of the new structure
  - Overview of coverage; *i.e* how the captive was used and why; how and why some risks remain in the commercial market
  - Premium funding to the captive
  - Captive surplus
  - Captive Budget as approved by Board
  - Update on market ..... Where do you go from here