captive insurance times
The primary source of global captive insurance news and analysis
ISSUE129 Conference Issue

BUILT LIKE A BANK

THE RELATIONSHIP BETWEEN A CAPTIVE AND ITS MANAGER CAN DETERMINE A CAPTIVE'S SUCCESS.

ACTIVE CAPTIVE MANAGEMENT
To request a risk analysis, visit us online at:
www.activecaptive.com or call 800-921-0155

Banking on it

Becky Butcher finds out why captive insurance is such a natural fit for financial institutions and how they will continue to dominate the market

A recent Marsh Captive Landscape report revealed that financial institutions led the way in the captive insurance market last year, with a 24 percent share. Financial institutions also reported premium volumes of approximately $24.6 billion, and a surplus of around $40.05 billion.

“Financial institutions have had the greatest share of the captive market for as long as Marsh has produced the Captive Landscape Report, which is now in its tenth year,” says Ellen Charnley, global sales leader for Marsh’s global risk and specialties division.

"We work with a lot of financial institutions that use captives for a number of reasons. Primarily, financial institutions use captives to fund corporate risk, particularly professional liability risk, which is an important exposure in the US."

Captives are a "natural fit" for financial institutions, particularly banks, as they have a risk financing mindset that is arguably "more advanced" than some other industries.

"They understand the nature of building surplus in a regulated entity, and perhaps have a better handle on the tax implications than some other industries," Charnley says.

Financial institutions have been using captive insurance companies since the early 1990s and, in that time—throughout the different business cycles of hard and soft markets and the regulations surrounding captive insurance companies—have benefitted in a number of ways.

James Sheriff, shareholder in the financial institutions and banking and finance groups at law firm Reinhart Boerner Van Deuren, points to the US State of Indiana as a good example of the dominant participation of financial institutions in captive insurance.

He says: "If we look at Indiana, where a bank captive programme was incubated some years ago with the Indiana Bankers Association, more than 85 percent of banks with more than $1 billion in assets now have captives in place. This signals a large opportunity for growth throughout the country in managing enterprise risk."

Bill Mourelatos, director at Aon Captive & Insurance Management, explains that, in the same vein as other large corporations, financial institutions with sizeable exposures are using captives to self-insure these exposures more efficiently than they would when purchasing commercial insurance, with a real driving force to reduce premium spends.

Bank risk exposures are constantly changing and evolving, with new risks such as cyber, political, reputational and other non-traditionals emerging.

In most cases, commercial carriers are unable to provide the right solution to cover these kinds of risks. Mourelatos says that a captive can bridge the gap by allowing banks to insure these risks or ringfence them, and for offloading to specialty reinsurers.

Mourelatos also says that larger banks have for more than a decade utilised their captives to strengthen client relationships. Many banks are packaging or offering ancillary lines of insurance products, such as life, health and disability, and travel, with other financial products, including credit cards and financial planning products, in an effort to be a one-stop provider to their retail client base.

Many financial institutions are also using captives to insure unfunded risks. These include deductible layers, difference in condition coverage, and some limited excess layers, according to Sheriff.

He says: "As a bank grows and makes acquisitions, they are typically seeking to adjust their commercial insurance programme and retain more risk through higher deductibles in order to save on commercial premium. Also, banks are covering some emerging risks where commercial coverage is not yet available or competitive. There are typically significant tax benefits provided by these programmes."

Larger financial institutions that self-insure their employee benefits and workers' compensation can utilise a captive to increase their stop-loss attachment point, insuring some layers of risk at the captive, and significantly reducing their commercial stop-loss premiums, adds Sheriff.

Some of the more "forward-thinking" banks and financial service providers are using their captives as profit centres, Mourelatos suggests. While some revenue streams have been shut down by regulators, others are still emerging.

He comments: "One area that may become more prominent is where large commercial lenders are using their captives to insure property exposure on projects that they are financing."

Mourelatos predicts that the future use of banking captives will be driven by the size of the institution.

He says: "For smaller community banks that have historically not used captives as they struggled to meet risk distribution and risk transfer hurdles, the Protecting Americans from Tax Hikes Act provides them an opportunity through risk pools to use micro captives to insure risk and obtain the advantageous tax benefits that were not previously available."

Larger financial institutions will continue to seek ways to generate new revenue streams from their existing captives as well as insure uninsurable business risks such as credit and interest.

Mourelatos concludes that if regulators continue to target banks and other financial institutions for past practices, there could be an increase in captive use as commercial insurers will tighten capacity and require higher deductibles.

Agreeing with Mourelatos, Charnley suggests that the dominance of financial institutions in the captive market will continue in the foreseeable future.

However, she predicts that the communications and technology industry, which reported $4.8 billion of premium volume and $8.37 billion of surplus in 2016, could eventually "challenge the spot"—in terms of premium volume written, because it is writing the same kind of customer risk.

Charnley says: "That could really start to flip the scale, although I don't see that happening for a number of years. I think financial institutions will continue to dominate."

Josh Miller, CEO of KeyState, who also sits on the Nevada Captive Insurance Association board, says he has already seen a steady increase in the use of captives by mid-size institutions.

Miller comments: "As banks see their peers implementing captive insurance structures and as their primary regulators become more familiar and comfortable with the structures, I anticipate continued adoption of the structure by financial institutions."

He adds: "The formation and operation of a captive by a financial institution requires unique and specific knowledge of financial institutions and their regulatory confines. It's important that banks work with regulatory counsel familiar with captives when forming one."

"It is also suggested that banks work with service providers that have significant experience working with financial institution captives." **CIT**