Captive Risk and Reward

Aaron Hillebrandt, Principal and Consulting Actuary, Pinnacle Actuarial Resources, said diversification of risk is important—and a great strategy. "A captive's risk exposure is much greater, naturally, for a single coverage, and concentration of risk is much higher than in a captive writing multiple coverages," he said. Following are excerpts from an interview.

PINNACLE ACTUARIAL RESOURCES

Aaron Hillebrandt
Principal and Consulting Actuary
Pinnacle Actuarial Resources

"Captives have, over time, successfully established themselves as a viable solution for managing cyberrisk."

What are the advantages for insuring exposures through a captive?

Of course, the advantages and disadvantages of deploying a captive solution will vary by sector or line of business. But captives have a long and well-established track record as a good defense to changing conditions within the commercial insurance market. It is about control, and flexibility that sometimes is not offered within the commercial insurance market. The commercial market can be volatile at times, and captives can help organizations manage waves in the underwriting cycle. A commercial carrier can nonrenew, restrict limits or enact rate increases even when there are no material changes to an individual company's exposures or loss experience.

What do companies look for when insuring exposures through a captive insurance company?

Captives are useful for filling gaps in coverage. For example, a large and complex organization's various risk exposures may be treated differently by the commercial market. Certain risks within a complex organization may be more subject to rate increases or nonrenewal than others, causing holes within the organization's risk management program. Captives have the flexibility to fill those gaps. If a captive is already in place when a gap is created in the commercial insurance program, the captive can respond quickly.

Where do emerging risks come in?

Sometimes the commercial market can take time to catch up to new and different risks. When there are those new and emerging risks that don't fit neatly in an existing commercial market bucket, there may be opportunity for captives. Captives have demonstrated that they can be nimbler in many ways than commercial carriers. Captives can quickly assess and understand a complex and emerging risk, and take a comparable policy form and adjust it, as needed, to the risk's unique features. The commercial market can get to that point, but often over time. The commercial market for cyber liability has indeed gotten better, but it has taken 10-plus years.

Why are captive insurance companies seen as so efficient?

Captives are generally very nimble because of their operational structure. Traditional insurers, commercial carriers can be very large organizations with complex IT, marketing and administrative organizations. They often have expense ratios that can be 30% or more of premium. Captives may be seen as lean by comparison. Captives often outsource much of their administrative work to third-party accounting, legal and actuarial firms. Captives often operate with an expense ratio closer to 10% of premium, but there is variation depending on the type of captive and the complexity of the program. That efficient operating model gives captives a great advantage in innovating and being nimble. And it contributes greatly to captives' reputation for efficiency and flexibility.