B

etween 2005 and 2014, the number of captives increased by a little more than 3% each year. But then, in the subsequent years, 2015 and 2016, growth, in number of captives, has slowed down, to slightly more than 1% in 2015 and then slightly less than 1% in 2016. There are other factors to consider, though. There have been increases in total premium volume and total assets, for instance.

Recent growth in U.S. domiciles has far outpaced that of the international domiciles. There are now 35 states with active captives managed, and more than 30 with active captive legislation on the books. But there are still some important benefits to using an international domicile for a captive.

There are some redomestications from the international to the U.S. domiciles, and others going in the reverse direction; there are approximately equal numbers of these. There is no one reason for these changes; each has been guided by its own logic for why it decides to do that redomestication.

In terms of rationale for captive formation, there has been considerable growth in the number of medical stop loss captives, and existing captives are being used to also provide this coverage.

In general, there has been substantial growth in two types of captives: entrepreneurial and strategic. The former are those where the underlying goal is to make a profit; the latter are those formed for some strategic reason—for example, to finance some sort of risk strategy.

The domestic captives
The year 2017 was generally flat, in terms of captive growth in the U.S., onshore. But there is a lot of noise under the numbers—new formations, offset by closures. In Vermont, for example, there were 24 new captive formations, but that was offset by a larger number of closures: 42.

States with some form of niche appear to be leading the pack. Hawai'i attracted new captives from Japan, whose financial firms are interested in the state for their captives. North Carolina is the new location of choice for small captives, in part because of the lower up-front costs for new formations. Still, once the numbers of small captives are eliminated from consideration, there is a pretty good spread of captives among the states.

International captives
There has been a decline in the total number of international captives, which has been driven by the two largest domiciles, Bermuda and the Cayman Islands. Bermuda saw a net decrease of 37 captives, and the Cayman Islands had a net decrease of 15 captives. But both had a significant number of new formations. Bermuda issued 17 new licenses; the Cayman Islands issued 33 new licenses.

However, there were more closures than new formations, which was primarily driven by M&A activity, also by captives that were in runoff that were closed during the year. In particular, the Caymoms had seen significant M&A in the healthcare sector. When a healthcare system merges with another healthcare system, and there are two captives, it often makes sense to consolidate.

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By Dana Murphy
Bermuda saw strong global interest in new formations, including captives from Canada and Latin America. The Caymans’ Portfolio Insurance Company (PIC) legislation, which was enacted a couple of years ago, prompted the formation of three new PICs. (A PIC is a portfolio insurance company with a type of cell structure that allows there to be more than one incorporated limited liability entity within one active cell insurance license.)

The third largest domicile is Barbados, which had a very good year in 2017, with 20 new licensed captives, and only four surrendered licenses, for a net gain of 16. Among those 20 new licenses, six were from U.S. companies, six were from Latin American entities, four Canadian, three Caribbean, and one from Europe. Also, of their total captives, about 262, only some 52%, are Canadian companies. This is significant because many presume that Barbados is mainly a domicile for Canadian captives. That is partially true, given the 52% figure, but there is also a substantial number of U.S. captives domiciled there. Of the remainder, 25% originate from the U.S., 12% from the Caribbean, 5% Latin America, and 6%, other.

Europe
Europe, too, has been flat in terms of its new growth. There has been a general sense of maturity in the European market, though there are exceptions, such as Guernsey, that continue to grow; Chinese companies are interested in this domicile, primarily because of its location. There has been a lot of growth, however, primarily in the cell structure entities.

But there has been an increase in total premium, and some new and interesting products are expected to emerge. Also, there may be more growth in European captives, as new developments emerge, as companies begin to centralize their risk management and put captives in a more central role, as a key element in their overall risk management strategy.

Cells and series
There has been an expansion in the variety of cells and series structures that are available, like the more recent portfolio insurance structure seen in the Cayman Islands. And there are incorporated cell structures that are available in several domiciles. There has been a greater marketing effort for cell structures, and many companies have come to appreciate the less burdensome regulation of these structures.

For the international cell structure captives, the Cayman Islands and Guernsey predominate. Guernsey saw an increase of 75 new cell formations. The Caymans, though, are still the biggest domicile in terms of most cells by number: Two cell entities have approximately 100 cells each.

Several captive companies are looking to expand captive coverage beyond traditional lines, increasing the number of requests for strategic planning.

down to one captive.
In the U.S., Delaware was the first state to enact series LLC legislation. There was a decline in 2017, due to apprehension about what will happen with the small - 831(b) - structure.

In one specific application, the cell structure has been found to be a good way to manage the statutory minimum capitalization. Within a cell, since the statutory minimum is provided by the cell facility owner, through the core, the cells can then be capitalized looking at it from a risk focus only, as opposed to a risk focus plus statutory minimum. This may allow a lower capital cost of entry at the start of the program.

The biggest story of 2017 is the developments surrounding small captives in 2017; there has been a real cooling effect in small captives. Why? For one thing, they remain in the “RS Dirty Dozen” list, for instance.

But not all of the news has been bad. What has happened in 2017 may represent a helpful “cleaning” of the market. Some companies have been closing one captive, and opening another that meets the new tax and other requirements.

The experience in 2018 is expected to be the same, but on a smaller scale. Due to the increased cost of operation of single-parent captives, there may be fewer of them than of cell captives being formed. There will likely be closures of service providers for single-parent companies, in light of these changes.

But beyond all this noise, small captives can still be a great risk-management tool.

**Single parent P/C captives**
Unlike small captives, the world of traditional P/C captives has been quite uneventful. The number of new formations has continued to be fairly consistent, at a low level overall. There have been some closures, due to mergers and acquisitions of the parent companies.

Several captive companies are looking to expand captive coverage beyond traditional lines, increasing the number of requests for strategic planning. We can probably expect this sector, going forward, to be slow and steady in terms of growth.

**Groups and RRGs**
There was limited formation activity among RRGs and group captives insuring P/C risk. RRG formations were at their lowest level in 15 years (five formations in total). But group captive and RRG activity remains strong. RRG premium exceed $3 billion, with more than 300,000 policyholders. Group captive growth remains strong, despite a soft commercial market.

RRGs are at their lowest number since 2005—228—in part because the commercial market still remains relatively soft. The number of physician RRGs has been declining, in part because of the movement of physicians to hospital and other employment.

Still, the RRGs overall remain very healthy. They continue to glean roughly $3.2 billion in premium, with more than 300,000 in policyholders.

**The future**
Some predictions for the future:
- Cell captives - will continue to see expansion
- Small captives - maybe a slight decline or hold steady
- Single parent captives, in total numbers, expected to hold steady or see a slight decline, happening in relation to what is occurring in M&A
- Single-parent captives, numbers will hold steady, but they will see an increasing market in terms of premiums and assets.

Dana Murphy is Editor of Inside Medical Liability magazine. This article was based on a webinar presented by Strategic Risk Solutions: 2018 – The State of the Captive Insurance Market.