Overall, 2015 was a good year for captives, considering how mature the captive industry is. There was a slight decrease in the rate of the formation of captives, at 4.8%, as compared with the 8.6% posted for 2014. Also, 2015 saw the emergence of 498 new captives; net addition (with the number of consolidations and closures subtracted) totaled 202. The captive market has become more complicated of late, and it is harder to keep track of all that is happening, as the number of domiciles, as well as the types of captives, continues to proliferate.

In particular, there was slowdown in the formation of small captives, in the wake of IRS scrutiny and some degree of uncertainty concerning the 831(b) election.

There were more cell formations than standalone captives in 2015; they’ve really taken off recently. The growth in cells and series in 2015 across just six domiciles (including Cayman, Delaware, and Tennessee) alone exceeded captive growth. This trend is expected to continue, as domiciles compete on legislation.

Meanwhile, closures among captives were significantly higher this year, up 75.1% from 2014. The reasons why this happened include re-domestications and consolidations among parent organizations, especially notable in the healthcare industry. Closures among small captives were, among other factors, a byproduct of parent company acquisitions, concern over IRS scrutiny, and basic market conditions. The ongoing soft market conditions in the commercial market primarily affected the group captives and risk retention groups (RRGs).

Changes in captive-regulation law, and the way that those laws are being implemented, have also driven some of the closures. Alternatively, some captive owners chose to pull up stakes and move to a more favorable domicile.

The distribution of total active captives across domiciles was led by Bermuda (800) and Cayman (707) and, in the U.S., Vermont (588). Several states have seen their efforts to entice captives pay off nicely. To cite two examples, Tennessee (captive numbers were up by 77.5%, from 71 in 2014 to 126 captives in 2015), while North Carolina saw a 77.4% increase over the same period, from 53 to 94 captives.

Considering new additions, Nevada led the pack, garnering 24 new captives, followed by Vermont, with 17 additions. At the other end of the spectrum were the domiciles that lost captives in 2015; Utah fared worst in this regard, losing 40 captives (from 106 in 2014 to 60 in 2015). And in regard to closures, Cayman experienced the biggest change, from 21 in 2015, to 74 in 2015.

The outlook for the remainder of 2016 suggests a general slowdown in the captives market, driven in part by the ongoing soft market. But at least it is expected to be a quieter year on the regulatory front, thanks to a focus on both national and state elections.

Group captives

Market conditions in the P/C market were not conducive to growth in the ranks of heterogeneous group captives. The months, September through December 2015, saw losses in numbers of these captives of -1%, -2%, -3%, and -4%, respectively.

One area that did see growth, however, was medical stop loss (MSL) captives, with increasing numbers of both single-parent and group MSL captives. The year 2015 saw ongoing growth for both single
- parent and group MSL captives, both heterogeneous and homogeneous. There was an increase in the numbers of larger mid-size employers (250 to 1,000 or more) joining group captives.

RRG numbers at this point seem to be flattening out, although they have rebounded somewhat from the first quarter of 2015, when they hit a low of 233. The current number is 236. RRGs tend to be the product of a hard market, for the most part, and there hasn’t been much of a hard market in several years. There haven’t been many new formations, and from 2013 to 2015, the number of retirements has slightly outstripped the formations.

Captives’ investments

Captives tend to live or die on their investment results. Rates are soft and underwriting profits are harder to come by, so clients are looking for extra return where they can get it. For this reason, there has been an ever-increasing emphasis on equities, and particularly on the indexed equity funds, as good investments for captives. At the same time, the credit profile required for fixed-income investments was lowered by some captives; now investment can increase yield by using less-than-investment-grade bonds.

But despite what was predicted for 2015, there has been only a limited shift to alternative investments. At the same time, the trend in increasing numbers of loan-backs to parent companies persisted in 2015, as companies look for some other structure, that supports business goals, that allows them to use some of their excess surplus.

Overall, though, the investment environment for captive entities remains challenging.

Healthcare and MPL

As the pace of mergers among healthcare entities continues unabated, their healthcare captives are merging in tandem. Another notable trend is the expansion in the ranks of employed physicians who thereby become part of the health system’s insurance program, both for captive coverage and commercial coverage.

There are mixed opinions about the potential consequences of this. Some contend that there is more exposure and risk. But others argue that there is less exposure and risk now that the formerly independently practicing physicians are employees. There has certainly been more discussion concerning prior acts and tail coverage for these now-employed physicians.

But one thing is certain: The prolonged soft commercial market is exerting a definite impact on captive activity for medical professional liability (MPL) coverage. This has led to closures of some of the MPL captives. And because there hasn’t been a hard market for such a long time, there haven’t been many formations of new captives. Some of the captives that were retired in 2015 were, historically, MPL-related. And with all of the MPL companies competing with each other to write business, and driving premiums down, many of the RRGs said, “We’re not going to try and match the market. The problem we were trying to solve has pretty much gone away, so I’m not sure we really need to keep operating.”

The upshot has been a shakeout in the RRG space as a whole, other than some particular areas where they have been in operation a long time and have a good market—something akin to market control.

The premium for MPL in this market in 2015 was $1.6 billion, basically flat, holding their own and have not grown. By industry, healthcare has the highest concentration by far, in terms of owning captives, and using captives for professional and general liability. But the whole shift toward hospitals buying physician practices and having employed physicians have prompted the employing institutions to ask, do we want to just put those risks in a captive—obviously the risk in an outpatient setting is different. Having the risk inside the hospital—there is a downside there as well. Because the market is soft, there is no shortage of options. Prices are very competitive for healthcare providers.