MARSH

Marsh Risk Management Research

2013 CAPTIVE BENCHMARKING REPORT

DISCOVERING OPPORTUNITY IN THE SHIFTING CAPTIVE LANDSCAPE

MAY 2013

CONTENTS

FOREWORD

Welcome to our sixth annual global captive benchmarking report. This year, we have taken a back-to-basics approach, focusing on the core captive benchmarking data points of greatest interest to captive owners, while considering what lies ahead from a global captive perspective.

Reflecting on our last five years of benchmarking data, we were able to identify key benchmarks and compelling findings from an industry perspective, as well as highlight overarching trends across all industries, domiciles, and coverages written. Additionally, we incorporated some new, innovative captive data points that we will build on and continue to measure in future editions of this report.

We trust that you will find the information and trends we've highlighted in this report to be of value.

On behalf of the 453 captive professionals who constitute Marsh's Global Captive Solutions team, we thank you for your interest in this report and invite you to contact your Marsh client executive or any other member of our team to discuss this report in greater detail.

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EXECUTIVE SUMMARY

This year, more than 1,220 captives managed by Marsh were benchmarked. Of those, 886 captives were selected for benchmarking analysis, representing approximately 15% of all captives globally. Following are some key findings from Marsh's *2013 Captive Benchmarking Report*.

CAPTIVE OWNERS BY REGION

- Seventy percent of captive owners are based in the Americas, 24% in Europe, and 6% in Asia-Pacific.
- Vermont is ranked first for US captive owners, Luxembourg for European captive owners, and Singapore for Asia captive owners.
- Latin America has shown increased interest and significant growth in alternative risk transfer programs. Many Latin American companies are well-positioned financially to consider larger self-insured retention in combination with traditional risk-transfer options, and are eager to improve their understanding of the business benefits, operational aspects, and financial benefits of using captives.

CAPTIVE TYPES

- As has been the case for the past 30 years, the majority of captives are single parent. This report focuses on variations of single-parent captives and does not address group captive facilities owned by more than one parent company.
  - Single parent captives: 84%
  - Cell captives: 3%
  - Risk retention groups: 4%
  - Group captive/other: 9%
- The use of certain alternative captive structures, such as rent-a-captives, protected cell companies, and risk retention groups, has been trending upward.

DOMICILES AND EMERGING DOMICILES

- The top three domiciles — Bermuda, the Cayman Islands, and Vermont — account for 36% of all captives globally.
- In the US, 31 states — plus the District of Columbia, Puerto Rico, and the US Virgin Islands — have captive legislation.
- Over the last five years there has been a significant number of emerging domiciles with captive legislation, including Oregon, New Jersey, Connecticut, and Louisiana.
- Other US states such as Maryland and Texas are proposing new captive legislation, with an eye to becoming a viable captive domicile.
- In addition, states such as Florida, Tennessee, Oklahoma, and Maine are all looking at captive growth in their states and strategically amending laws to be more accommodating and attractive to captive owners.
- Globally, domiciles such as Malta in the European Union are continuing to gain popularity, especially with German companies.
- For Asia-Pacific-based companies, The Federated States of Micronesia is growing and now has nine total captives.

CAPTIVE INVESTMENT PORTFOLIOS

- A significant number of captives enter into intercompany investments or loans with their parent companies, a growing trend since the economic crisis of 2008, as companies need access to cash and cannot maintain large amounts of cash in captives, earning relatively low returns. Higher yields can be earned in captives, however, with the use of an investment manager or corporate treasury.

CAPTIVE REINSURANCE

- Approximately 43% of captives managed by Marsh access reinsurance. This percentage varies by region of parent company; Asia, Australia, the Middle East, and Africa have the highest percentage of reinsurance protection.

- Although not defined as "accessing reinsurance," in the US coverages supported by the Terrorism Risk Insurance Act (TRIA) and amendment acts continue to be insured by captives, providing access to the backstop for conventional terrorism and excluded perils, such as nuclear, biological, chemical, and radiological (NBCR). TRIA is set to expire on December 31, 2014, unless renewed. Legislation that would simply extend the program to 2019 has been introduced; however, it is thought that any extension measures would change the current act's participation and potentially limit certain current TRIA coverages.

TRADITIONAL AND NON-TRADITIONAL CAPTIVE USE

- Traditionally, the predominant lines of coverage in captives, in order of size, continue to be general/third party liability, property, employers' liability/workers' compensation, automobile liability, and professional liability.

- From a non-traditional perspective, although employee benefits (for US employees) captive use has not grown substantially, increases in medical stop-loss have been seen. Additionally, various financial product coverages (crime, political risk, trade credit, surety, and intellectual property) are also being insured in many captives. There has also been a slight increase in supply chain risk and the emergence of cyber liability being written in captives.

THIRD PARTY BUSINESS

- Ten percent of captives insure some amount of third party risk, such as customer credit insurance, extended warranty, pooling facilities, or employee benefits (life, disability, and health). This trend is expected to increase as captive owners will likely continue to want to explore diversification options, improve profitability, and support risk distribution to allow for premium tax deductibility.

CAPTIVE SIZE: PREMIUM VOLUME

- Forty-four percent of captives had premium volume of less than US$5 million, suggesting there is no "one-size-fits-all" captives. This finding also suggests, however, that the premium spend required to support a captive is attainable by small, midsize, and large organizations.

OWNERS WITH MULTIPLE CAPTIVES AND CHANGES IN CAPTIVE STATUS

- In benchmarking all industry data on captives (beyond the 886 captives used for this report), there are approximately 690 captives owned by a parent company that has more than one captive, constituting 299 owners. Americas owners account for 58% of the 299 owners of multiple captives.

CAPTIVE OWNERS BY INDUSTRY

- Financial institutions remain the largest users of captives, followed closely by health care companies. Beyond these top industries are retail and consumer products, and manufacturing, which share nearly equal proportions of the market. Combined, these industries accounted for 54% of all captives globally.

- Financial institutions use captives for funding for large professional liability risks, such as errors and omissions (E&O), and also for significant customer programs, representing third party business in their captives.

- Health care institutions continue to value the balance-sheet discipline that supports their hospital professional liability (HPL), professional liability, and general liability risk management programs.

1. BACK TO BASICS

Following is core benchmarking data that ranges from location of captive owners to domicile issues, captive investment portfolios, and reinsurance ceded.

1.1 CAPTIVE OWNERS BY REGION

CAPTIVE OWNERS

The majority of captive owners are from the Americas (70%), a trend that has existed for many years, followed by European owners at 24%, and Asia and Pacific owners at 6% (see Figure 1). European organizations have slowed their captive formations in the EU, as reflected by the flat growth from 2011 to 2012, due to uncertainty in the EU surrounding the implementation of Solvency II. This trend has been ongoing for the past three years.

FIGURE 1: CAPTIVE OWNERSHIP BY OWNER REGION

LOCATION	AMOUNT	2012	2011
Americas	631	70%	72%
Europe	213	24%	24%
Asia-Pacific	42	6%	5%
TOTAL	886		

Source: Marsh

Companies based in the Americas tend to be more comfortable with taking significant risk for primary casualty coverages (workers' compensation, general and product liability, and automobile liability). In addition, tax-accounting regulations allow for tax deductions on property and casualty reserves in the Americas and Europe, thereby providing additional economic advantages for captives, compared with self-insurance.

The majority of European captives are owned by UK, French, Luxembourg, Swiss, or Swedish companies. Insurance premium tax rates differ from member state to member state, ranging from 6% to more than 20%. However, the emergence of new low-income-tax-rate EU domiciles — such as Gibraltar, Ireland, and Malta — and legal precedence supporting the "freedom of establishment" (whereby an owner can select a domicile and tax rate without challenge from its home country) is a development that continues to fuel interest.

UK captive owners are increasingly interested in alternative captive vehicles, such as virtual captives (balance sheet funds operated by a captive manager), self-insurance trusts, and mutuals as a way of funding group risks.

Asia-Pacific companies tend to be more risk averse, assuming lower retentions and deductibles and purchasing more insurance in the commercial markets. Over the past five years, Asia-Pacific companies' use of captives has remained relatively unchanged at approximately 5% to 6% of total captives worldwide.

1.2 CAPTIVE TYPES

Single-parent captives are the most common form of captives, accounting for 84% of all formalized risk finance vehicles (see Figure 2). The reason for this statistic is simple: many organizations — as well as smaller private companies — want the control, flexibility, and oversight of their own facility. There are excellent reasons for joining a group captive, being part of a cell facility, and pooling; however, the trend for ultimate control continues to reign.

FIGURE 2: TYPE OF RISK-FINANCING VEHICLE RANKING AND PERCENTAGE

RANK	CAPTIVE TYPE	PERCENTAGE
1	Single-Parent Captive	84%
2	Group Captive	8%
3	Risk Retention Group	4%
4	Cell — SPC, PCC, ICC	3%
5	Other Captive Types and SPVs	1%

Source: Marsh

Alternative vehicles such as rent-a-captives (RACs), protected cell companies (PCCs), incorporated cell captives (ICCs), risk retention groups (RRGs), and special-purpose vehicles (SPVs) are being used more often than in the past due to distinct benefits that each offers. These types of vehicles not only formalize risk financing, but may also operate at a lower cost and with lower capital requirements than traditional wholly owned captives. In recent years, a greater number of non-single-parent captives have been formed, as observed when comparing year of establishment by captive type.

Continued growth in alternative arrangements is expected, driven by organizations that are perhaps not large enough for a single-parent captive, yet have the desire to participate in their own risk, such as financial institutions that tend to form SPVs and life insurance captives. (This report does not focus on SPVs or life insurance captives, often used by insurers and reinsurers to transfer risk to capital markets via the issuance of securities to investors.)

1.3 DOMICILES AND EMERGING DOMICILES

Bermuda and the Cayman Islands continue to rank at the top of the list of preferred domiciles for captive owners, followed closely by Vermont. This trend is expected to continue for the foreseeable future, as many captive owners (and future owners) view these top domiciles as mature and stable, with excellent regulation, deep captive experience, and solid captive infrastructure.

Figure 3 shows the top 30 domiciles for all captives.

FIGURE 3: GLOBAL CAPTIVE DOMICILE RANK BY NUMBER OF CAPTIVE LICENSES

RANK	DOMICILE	2012	2011
1	Bermuda	856	862
2	Cayman Islands	741	739
3	Vermont	586	590
4	Guernsey	333	343
5	Anguilla	291	268
6	Utah	287	239
7	Barbados	261	270
8	Luxembourg	238	242
9	Nevis	203	150
10	Delaware	190	150
11	Hawaii	179	172
12	District of Columbia	170	157
13	British Virgin Islands	157	174
14	South Carolina	149	159
15	Dublin/Ireland	141	147
16	Kentucky	139	137
17	Nevada	133	127
18	Isle of Man	125	133
19	Montana	114	85
20	Arizona	101	97
21	Turks and Caicos	83	84
22	Singapore	66	60
23	New York	50	50
24	Sweden	49	49
25	Labuan	41	34
26	Switzerland	34	35
27	British Columbia	31	31
28	Puerto Rico	29	21
29	Missouri	28	19
30	Alabama	23	18

Source: Business Insurance, "Counting Captives," 11 March 2013

Traditionally, UK parents and companies based in the Americas favored offshore locations, such as Bermuda, Cayman, Guernsey, and Isle of Man, as these jurisdictions were the first to embrace the captive industry and enact appropriate captive legislation. With the exception of Vermont, onshore jurisdictions typically embraced the captive industry somewhat later — and only then after much momentum was developed by the top offshore domiciles. Onshore domiciles are defined as US states or US possessions, EU, Dubai, Singapore, and Australia. Offshore domiciles are defined as all other.

As more onshore jurisdictions enact captive legislation, the number of alternative captive domiciles increases, challenging the prominence of the established jurisdictions (offshore domiciles and Vermont). Of the 29 captive domiciles where Marsh maintains captive management licenses and manages captives, only five domiciles (17%) are considered offshore, but they represent 45% of the global captive market. Vermont, a mature and longstanding onshore domicile, has seen only a few captives migrate to other US onshore jurisdictions as more US states enact captive legislation and entice businesses to move their captives.

Overall, the trend for companies to be based in an onshore domicile has grown by three points in the last year (see Figure 4A). At the end of 2012, 55% of companies had onshore captives versus 45% domiciled in offshore locations.

While formation of new captives is trending toward onshore domiciles (see Figure 4B), the market is not seeing a large number of offshore captives re-domicile to onshore jurisdictions. Some recent movements were not based on one fact or set of circumstances, and re-domestications are often neutral in both directions.

FIGURE 4A: GLOBAL CAPTIVE ONSHORE AND OFFSHORE DOMICILE COMPARISON

LOCATION	AMOUNT	2012	2011
Onshore	489	55%	52%
Offshore	397	45%	48%

Source: Marsh

FIGURE 4B: CAPTIVE FORMATION COMPARISON - ONSHORE VS. OFFSHORE

YEAR FORMED	TOTAL PERCENT	ONSHORE	OFFSHORE
2001 to 2011	52%	52%	48%
1991 to 2000	27%	35%	65%
1981 to 1990	13%	32%	68%
Pre 1981	8%	5%	95%
TOTAL	100%	41%	59%

Source: Marsh

In examining Europe and the Americas more closely, Americas-owned captives are close to an even split between onshore and offshore (see Figure 5A). However, Europe has a lot more captives located in onshore domiciles (see Figure 5B), a trend that is consistent with the previous year — and one that likely reflects the increasing number of European captive domiciles and the ability to insure directly in all EU countries under the EU Freedom of Services Act (FOS). The FOS allows an EU insurer to insure risks in another EU-member state on an admitted basis without incurring additional regulation or taxes. This is similar to the US Liability Risk Retention Act (LRRA), which allows risk retention groups to insure liability risks across all 50 US states.

FIGURE 5A: AMERICAS GLOBAL CAPTIVE DOMICILES

DOMICILES	AMOUNT	PERCENTAGE
Americas – Onshore	297	47%
Americas – Offshore (Primarily Bermuda and the Caribbean)	334	53%

Source: Marsh

FIGURE 5B: EUROPEAN GLOBAL CAPTIVE DOMICILES

DOMICILES	AMOUNT	PERCENTAGE
Europe – Onshore	149	69%
Europe – Offshore	63	31%

Source: Marsh

EUROPE ONSHORE DOMICILES

Malta has attracted a number of world-class organizations and continues to be the fastest-growing EU domicile, with a 33% increase in captives managed between 2011 and 2012. Of all Maltese captives, 81% of parent companies are based in Europe. Luxembourg and Dublin continue to be the largest onshore EU domiciles, with a combined 84% of all EU onshore captives, while Sweden (although still considered a small domicile) has seen continued growth.

Uncertainty surrounding Solvency II continues to slow the growth of European onshore domiciles; new captive formation in 2012 was lower than what would ordinarily be expected. The European Insurance and Occupational Pensions Authority (EIOPA) has announced its intention to issue guidelines on interim measures surrounding key implementation issues with the intention that these guidelines be operational in 2014. Beyond that, it is unlikely that full implementation of Solvency II will be effected until 2015 at the earliest.

EUROPE OFFSHORE DOMICILES

Guernsey (with 62% of EU offshore captives) and the Isle of Man (with 38% of EU offshore captives) looked very much the same in 2012 as they did in 2011, with 333 captives and 125 captives, respectively.

The recent UK Controlled Foreign Corporation reform could make the captive proposition for UK companies more favorable. The changes seek to tax only captive profits derived from insuring UK business. As a result, profits from insuring non-UK risk might not be taxed in the UK, subject to the significant “persons function” or “substance” requirements. But UK companies will likely view any tax efficiencies as incidental and a bonus to captive establishment, as they were among the first to embrace captives to reduce total cost of risk, formalize risk management, access reinsurance markets, and insure difficult-to-place or “uninsurable” risks.

AMERICAS ONSHORE DOMICILE TRENDS

Vermont was again the top-ranked global onshore domicile for Americas-based parent companies, while Luxembourg was the top non-US onshore domicile (see Figure 6).

FIGURE 6: ONSHORE CAPTIVE DOMICILE COMPARISON

UNITED STATES DOMICILES	NUMBER OF CAPTIVES	2012
Vermont	186	63%
Hawaii	44	15%
South Carolina	39	13%
New York	17	6%
Arizona	10	3%

OTHER DOMICILES	NUMBER OF CAPTIVES	2012
Luxembourg	69	36%
Dublin	47	24%
Singapore	37	19%
Malta	16	8%
Sweden	11	6%
Switzerland	6	3%
Australia	5	3%
British Columbia	1	0.5%
Dubai	1	0.5%

Source: Marsh

In the United States, 31 states — plus the District of Columbia, Puerto Rico, and the US Virgin Islands — have laws allowing captive formations. Many of these states, including Oregon, New Jersey, Connecticut, Louisiana, and Alabama, have created laws in the last decade. Other states, such as Maryland and Texas, have legislation proposed and may be viable captive domiciles in the future. Furthermore, states like Florida, Maine, Oklahoma, and Tennessee have resurrected older, outdated statutes to become more competitive in the domicile marketplace.

AMERICAS OFFSHORE DOMICILE TRENDS

Bermuda retained its number-one position with a total share of 49% of offshore captive owners in 2012 (see Figure 7).

FIGURE 7: OFFSHORE CAPTIVE DOMICILE COMPARISON

OFFSHORE	NUMBER OF CAPTIVES	2012
Bermuda	194	49%
Cayman	113	29%
Guernsey	42	11%
Barbados	27	7%
Isle of Man	21	4%

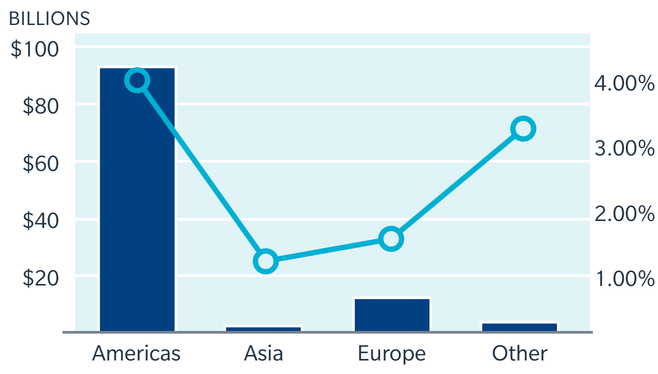
Source: Marsh

Cayman is home to a substantial number of the Americas' health care captives for both for-profit and not-for-profit organizations. It is the primary choice for many of these health care institutions because of its regulation, regulator expertise, infrastructure, and experience.

1.4 CAPTIVE INVESTMENT PORTFOLIOS

Figure 8 shows net investment income for captives based on the captive owner's region. Americas-based captive owners have significantly more investable assets than any other geography because there are generally larger primary casualty programs with higher premiums and capital.

FIGURE 8: TOTAL INVESTMENTS AND INVESTMENT YIELD BY OWNER REGION

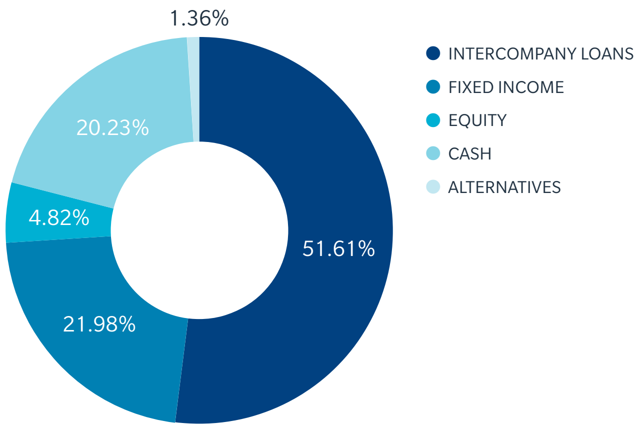


Source: Marsh

INTERCOMPANY INVESTMENTS

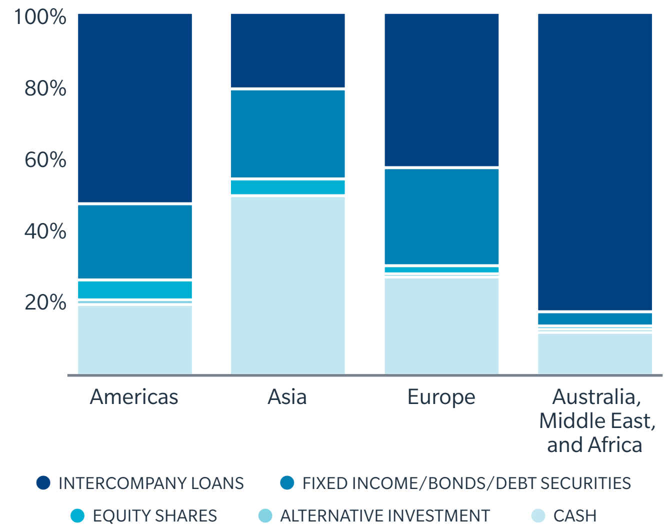
In analyzing all investment types for all captives, a large number of captives use intercompany investments as a significant percentage of the overall investment portfolio (see Figure 9), especially since the economic downturn of 2008, when captives were heavily invested in equities. Such investments are classified as demand loans, securitized loans, factored accounts receivables, notes, and other financing secured by assets such as fleets, inventory, and other assets.

FIGURE 9: AGGREGATE INVESTMENT TYPE FOR ALL CAPTIVES



Source: Marsh

FIGURE 10: TYPE OF INVESTMENT BY OWNER REGION



Source: Marsh

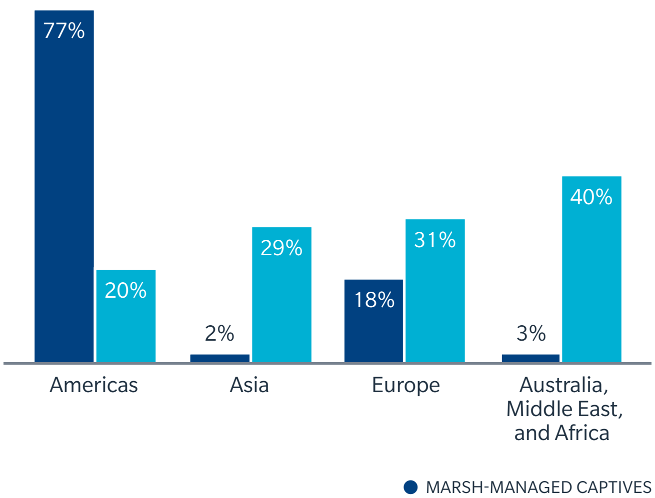
The reason for this approach is that captive owners need to access much of the captive's assets to avoid any opportunity costs associated with using the captive. With the right approach and a diversified investment policy, a captive can achieve an acceptable balance of access to cash and investments. More than half of all captives' assets are typically invested in some form of intercompany investments with the parent entity or affiliates, done primarily to minimize the cost of capital employed in the captive and enhance the parent company's liquidity. Another benefit is that the parent company has greater control over the captive's invested assets.

In looking at investment makeup from an owner's regional point of view, Asian captives hold up to 50% of assets in cash, while Australian, Middle East, and African captives loan as much as 80% of assets back to the parent group (see Figure 10).

Americas and European captives tend to have similar investment policies, using intercompany loans for 40% to 50% of assets to reduce the cost of capital, while maintaining diversified investment securities of approximately 20% to 30% of assets to capture investment yield, and 20% to 30% cash for liquidity and working capital. In the Americas, this approach is explained by the fact that most captives generally have more predictable casualty lines of coverage, which generate significant premium and capital; therefore, the funds in the captive are needed for the efficient use of the parent company's capital.

Figure 11 represents the amount of intercompany loans by owner region. This chart also shows the percentage of Marsh-managed captives in these regions to provide additional context around the robustness of the data.

FIGURE 11: INTERCOMPANY INVESTMENTS BY OWNER REGION AND MARSH-MANAGED CAPTIVE PERCENTAGE



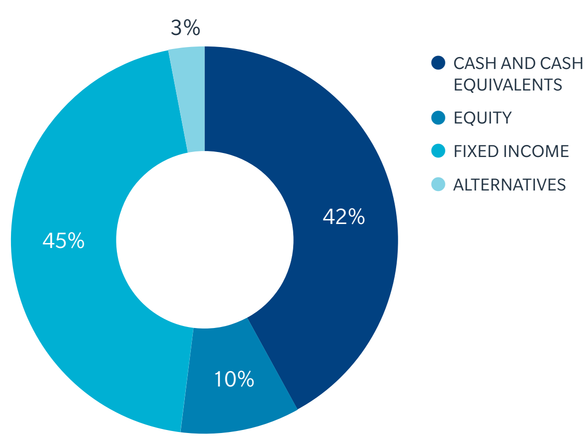
Source: Marsh

NON-INTERCOMPANY INVESTMENTS

In looking at intercompany investments by region, the typical captive investment policy for assets not loaned back to a parent company is similar to a typical commercial insurer (see Figure 12). Commercial insurers tend to invest in fixed income and cash and cash-equivalent securities, with minimal equity exposure.

Although the average captive investment mix is similar to a typical commercial insurer (see Figure 12), the underlying data reveals a wide range of investment strategies. A large number of captives invest exclusively in cash and cash equivalents, and some employ much larger allocations to equity (30%+) and alternative investments, which include hedge funds and private equity investments. The wide range of investment strategies reflects the flexibility of captives and the growing comfort of regulators to diversify captive assets in the right circumstances, as well as differences in capital requirements, insurance loss payout patterns, and type of risk insured.

FIGURE 12: TYPE OF INVESTMENT FOR NON-INTERCOMPANY INVESTMENTS FOR ALL CAPTIVES



Source: Marsh

1.5 REINSURANCE

REINSURANCE PROTECTION

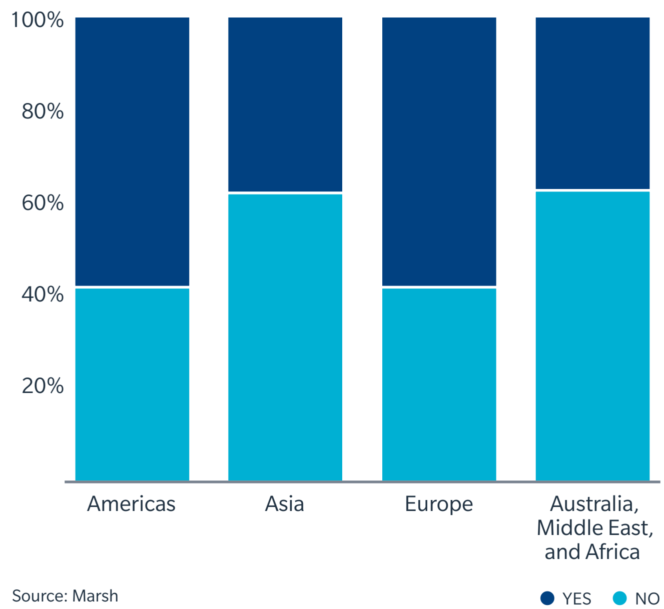
A key benefit for captives is the ability to access global reinsurance markets where available capacity, pricing, and terms and conditions can be more favorable than in direct markets. In certain circumstances, a captive can earn ceding commissions from reinsurers, providing a source of additional profit. In addition, accessing the commercial market via reinsurance gives captive owners a greater ability to manuscript and negotiate better policy terms than the primary insurance market may offer (see Figures 13 and 14). Figure 13 shows reinsurance accessed by captive owner region, while Figure 14 shows reinsurance accessed by captive domicile.

43% of captives purchased reinsurance protection

Breaking out access to reinsurance by captive domicile and captive owners by region highlights which geographies tend to access reinsurance.

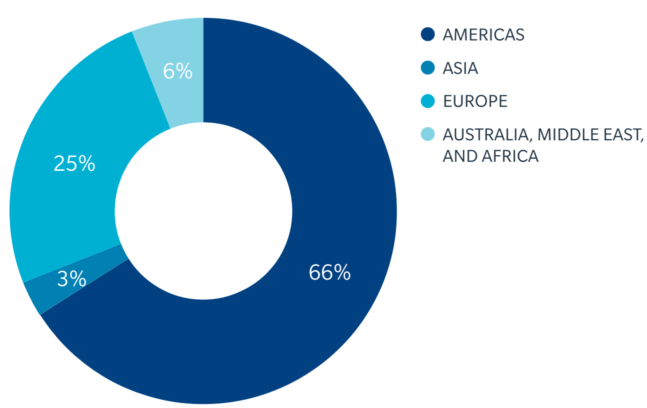
Traditionally, many captives have been comfortable retaining deductible layers and self-insured retentions that are predictable and less volatile; the volatile excess layers are typically ceded to the commercial market. However, as national catastrophic risks become increasingly difficult to place and premiums increase, captives are also increasingly being considered as a viable alternative to front for certain lines of coverage, then access reinsurance where appropriate.

FIGURE 13: REINSURANCE ACCESSED BY OWNER REGION



Source: Marsh

FIGURE 14: REINSURANCE ACCESSED BY CAPTIVE DOMICILE REGION



Source: Marsh

2. TRADITIONAL COVERAGES

As captive owners continue to self-insure traditional insurance lines, the top five risks remain unchanged (see Figure 15).

FIGURE 15: TOP FIVE RISKS INSURED BY CAPTIVES

CAPTIVE COVERAGE	PERCENTAGE
General/Third Party	36%
Property	32%
Employers' Liability/Workers' Compensation	25%
Automobile Liability	20%
Professional Liability	20%

Source: Marsh

Figure 16 shows the full range of traditional insurance lines and the percentage of captives insuring each one.

Traditional coverages continue to represent the predominant risks within captives for a number of reasons, in that they:

- Provide funding for relatively predictable, stable, self-insured annual losses within a company's retentions.
- Provide the ability to offer guaranteed-cost insurance coverage to business units, where the parent can assume a higher retention, but where smaller business units want and require budget stability and protection.

Additionally, captive owners continue to cite the following leading reasons for captive formation and use:

- To formalize risk-retention financing.
- To enhance focus and discipline in risk control of fundamental exposures.
- To access other markets, such as reinsurance and local pool arrangements.
- To fund uninsurable risk and/or risk that is deemed to be overpriced by the marketplace.

From an Americas perspective, 69 captives, or 8% of this report's sample group, are writing terrorism coverage, backstopped by the US government's Terrorism Risk Insurance Act (TRIA, and extension acts) for conventional terrorism, and largely for nuclear, biological, chemical, and radiological (NBCR) events. NBCR perils are excluded by most commercial property policies, but captives remain a solution to cover these risks. TRIA is set to expire on December 31, 2014, unless it is extended again by the US Congress, which many industry experts believe is likely.

FIGURE 16: TRADITIONAL INSURANCE COVERAGE WRITTEN BY CAPTIVES

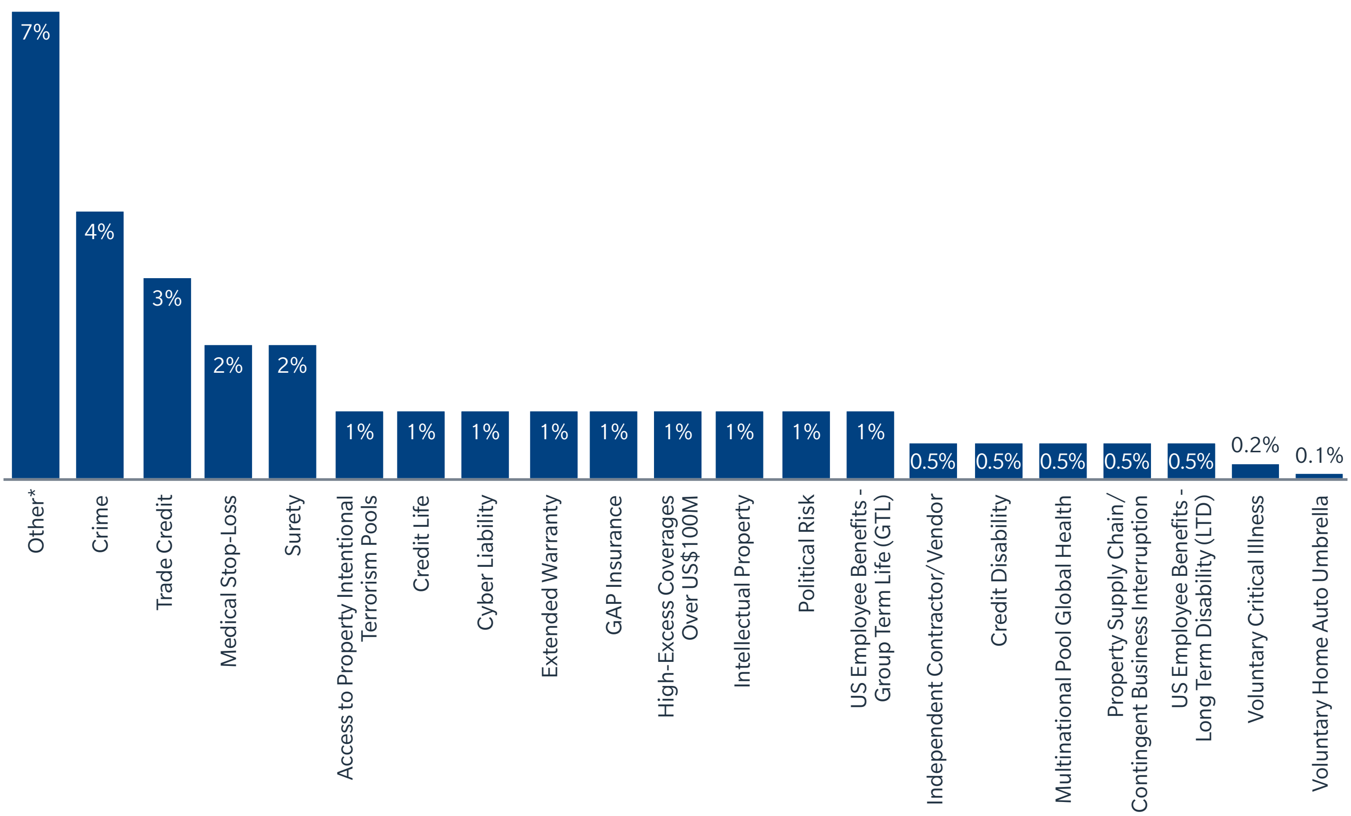
- 36% General Public Third Party Liability
- 32% Property All-Risk
- 25% Workers' Comp/Employers' Liability
- 20% Casualty Auto Liability
- 20% Professional Liability
- 16% Other Financial Lines
- 11% Product Liability
- 9% Excess Liability
- 8% Medical Malpractice Liability
- 8% US TRIA/NBCR
- 7% Property Cargo
- 7% Property Marine
- 6% Property Terrorism Non-US TRIA
- 5% Environmental Liability
- 5% Errors and Omissions
- 4% Directors and Officers Liability
- 3% Aviation Liability
- 3% Umbrella Liability
- 2% Employment Practices Liability
- 2% Fidelity
- 2% Fiduciary
- 2% Marine Liability

Source: Marsh

3. NON-TRADITIONAL COVERAGES

While many captives continue to be used, wholly or substantially, for traditional lines of insurance, there is an increasing trend over the past five years for captive owners to insure/reinsure non-traditional coverages such as cyber liability, supply chain risk, medical stop-loss, and financial and professional coverages (see Figure 17).

FIGURE 17: NON-TRADITIONAL INSURANCE COVERAGE WRITTEN BY CAPTIVES



* Includes various property and casualty lines, plus some financial and professional lines. Source: Marsh

4. THIRD PARTY BUSINESS

10% of captives write some amount of third party unrelated risk

While many captives continue to be used, wholly or substantially, for traditional lines of insurance, there is also an increasing trend where captive owners, particularly in retail and consumer products industries, develop insurance products to offer their customers, using a captive to generate additional revenue. In most domiciles, this approach changes the status of a captive from writing purely for corporate risks to acting as a third party insurer. These unrelated lines of coverage are usually written on a fronted reinsurance basis to mitigate regulatory and consumer issues. Although this report focuses on employee benefits, other third party offerings include voluntary personal lines, warranty, credit, joint venture, and independent contractor coverages.

This section of the report focuses on employee benefits as a source of unrelated risk. There are three types of third party employee benefits reinsured by captives:

1. US employee benefits (group term life and long-term disability, covered by the Employee Retirement Income Security Act [ERISA]).

2. Global benefits (multinational pooled benefits).

3. Voluntary employee benefits (home, auto, umbrella, and critical illness).

Gaining in popularity are global employee benefits (life, disability, health). Considered similar in profile to a property risk, this class is a substantial spend for many organizations — including multinational pooling arrangements reinsured by a captive that may result in significant premium/cost savings.

The process to underwrite employee benefits in a captive differs between the US and the rest of world. The US is more restrictive, as companies must follow a Department of Labor (DOL) ERISA approval process. There were four final DOL approvals for companies in 2012 looking to reinsure benefits with their captive, despite the fact that the expedited approval process for streamlining DOL exemptions in 78 days was suspended by the DOL until further notice.

Outside of ERISA employee benefits programs, US captive owners are increasingly assessing the viability of providing medical stop-loss insurance, as the cap on lifetime limits is phased out under the Patient Protection Affordable Care Act (PPACA). As this coverage is not considered health insurance, it is not subject to the ERISA provisions and DOL approval is not required. Voluntary benefits, such as group home, umbrella, auto, and critical illness, have also been explored, but have been slow to gain traction in captives, primarily due to the premium volume generated by most organizations and low employee uptake rates.

In Europe, varying regulatory requirements need to be carefully considered. Marsh's benchmarking data suggests that a large proportion of captive owners have expressed an interest in the potential advantages of including employee benefits.

Captives will likely continue to seek out additional third party risk for a number of reasons, including:

- Diversifying the captive's risk profile.

- Optimizing international risk finance of employee benefits.

- Achieving profitability in the captive and to offset volatility in related lines of coverage.

- Supporting risk distribution to allow for premium tax deductibility.

5. CAPTIVE SIZE: PREMIUM VOLUME BY CAPTIVE

In this year's report, captive size was reviewed based on net premiums as follows:

- Small – Less than US$1.2 million
- Medium – US$1.2 million to US$5 million
- Large – US$5 million to US$20 million
- Extra Large – Above US$20 million

FIGURE 18: CAPTIVE SIZE BASED ON NET WRITTEN PREMIUM

SIZE OF CAPTIVE	PERCENTAGE
Small	21%
Medium	23%
Large	15%
Extra Large	27%
Captives in Run-off	14%

The number of captives in "run-off" represents captives that may have been in run-off for many years. As a result of the economic downturn in 2008, many captives have been "put on a shelf" so that the company can quickly start up operations again in a hard economy or when needed. In addition, some captives have been merged or liquidated. Captives in the EU cannot simply merge or liquidate, so owners will often place an EU direct-writing captive into run-off until they determine the risk management needs of the company.

Source: Marsh

Notably, 44% of captives had premium volume of less than US$5 million (see Figure 18), reinforcing the notion that captives are owned by organizations of all sizes and there is no "one-size-fits-all" for captive owners.

A large percentage of small US captives may elect to be treated as a "small insurance company" under the Internal Revenue Code (IRC) Section 831(b), and only pay income tax on investment income (and not on underwriting profits of the captive). Similarly, small UK-owned captives may benefit from the increased UK Controlled Foreign Corporation de minimis profit threshold of £500,000 and can earn profits tax free.

6. OWNERS WITH MULTIPLE CAPTIVES

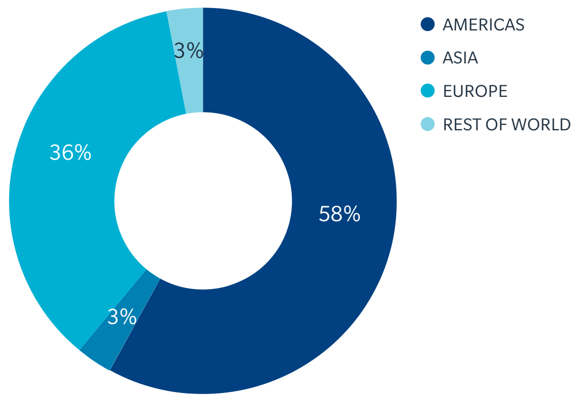
To assess the current estimated number of owners with more than one captive, this report looks beyond just the captives under management by Marsh, using A.M. Best Company's captive industry information, as well as other supporting data. Using these sources, it is estimated that there are approximately 690 captives owned by a parent company with more than one captive (for a breakdown by region, by owner region, and by owner country, see Figures 19, 20, and 21, respectively).

FIGURE 19: COMPANIES WITH MORE THAN ONE CAPTIVE

PARENT REGION	NUMBER OF COMPANIES
Americas	174
Asia	9
Europe	108
Rest of World	8
TOTAL	299

Source: A.M. Best Company, other industry and Marsh sources

FIGURE 20: COMPANIES WITH MORE THAN ONE CAPTIVE BY OWNER REGION



Source: A.M. Best Company, other industry and Marsh sources

Companies located in the Americas tend to have multiple captives for various reasons, including the requirement of having a branch captive of an offshore domicile to access TRIA in the US or to reinsure ERISA employee benefits. Other reasons for having multiple captives involve financial institutions, which require multiple captives for various lines of coverage, such as corporate risks versus third party credit life, debt cancellation, or even private mortgage insurance in prior years. In addition, many companies acquire other companies that have captives as well, therefore ending up with multiple captives — perhaps one onshore and one offshore — and realizing that there are benefits to that structure.

Figure 21 shows the number of parent companies with more than one captive by country.

FIGURE 21: COMPANIES WITH MORE THAN ONE CAPTIVE BY OWNER COUNTRY

PARENT ORIGIN	NUMBER OF COMPANIES	PERCENTAGE
Australia	5	1.7%
Austria	1	0.3%
Belgium	4	1.3%
Bermuda	17	5.7%
Brazil	1	0.3%
Canada	12	4.0%
Cayman Islands	1	0.3%
Denmark	2	0.7%
Finland	2	0.7%
France	13	4.4%
Germany	7	2.3%
Guernsey	1	0.3%
Isle Of Man	2	0.7%
Italy	3	1.0%
Jamaica	1	0.3%
Japan	9	3.0%
Luxembourg	2	0.7%
Netherlands	6	2.0%
Netherlands Antilles	1	0.3%
New Zealand	1	0.3%
Norway	1	0.3%
Panama	2	0.7%
South Africa	2	0.7%
Spain	1	0.3%
Sweden	15	5.0%
Switzerland	6	2.0%
United Kingdom	42	14.1%
United States	139	46.5%
GRAND TOTAL	299	

Source: A.M. Best Company, other industry and Marsh sources

7. CHANGES IN CAPTIVE STATUS

Changes in captive status include "run-off," whereby a company chooses not to write any additional premium for a number of years, in essence putting a captive "on the shelf." Other changes in captive status can include:

- A complete liquidation by the captive's owner, involving the removal of all assets and liabilities from the captive and the closure of the captive.
- Re-domesticating a captive to a new domicile.
- The sale of a captive to another owner (as the market has seen occur in Europe over the past two years).

Figure 22 summarizes typical changes in a captive's status between 2011 and 2012. Many of the captives in run-off have been in run-off for many years, therefore this is a cumulative percentage. Of the 16 captives that re-domiciled in 2012, Figure 23 shows the domiciles seeing re-domestication. No large-scale movement from offshore to onshore has been seen, nor has the US seen any significant re-domestications.

FIGURE 22: TYPICAL CHANGES IN A CAPTIVE'S STATUS

CAPTIVE STATUS	PERCENTAGE	NUMBER OF CAPTIVES
Run-off (may be cumulative)	14%	117
Liquidation	2%	17
Merger and Re-domestication	2%	16

Source: Marsh

FIGURE 23: DOMICILES SEEING RE-DOMESTICATIONS (INBOUND OR OUTBOUND)

Source: Marsh

8. REGULATORY DEVELOPMENTS

- Dodd-Frank Wall Street Reform and Consumer Protection Act

  – With the passage of the Nonadmitted and Reinsurance Reform Act of 2010 (Act), which took effect on July 21, 2011, no state, other than the home state of the buyer of the insurance policy, may require payment of self-procurement tax for non-admitted insurance.

  – Over the last 18 months, there have been various efforts by captive insurance associations to work with law firms to prepare white papers on the applicability of the Act to captives and to lobby Congress to obtain an amendment to the Act. In January, the outgoing chairman of the Subcommittee on Insurance of the Committee on Financial Services in the House of Representatives, in a letter to current committee members, reaffirmed that the Act was never intended to apply to captives, a sentiment that was echoed by a current member of Congress in February.

- Solvency II

  – Solvency II is unlikely to be fully implemented until 2015 at the earliest, but EIOPA will be issuing guidelines for EU regulators on interim measures regarding Solvency II, which will see some key areas addressed in 2014. These areas include:

    - System of governance.

    - Forward-looking own risk and solvency assessment (ORSA) submission of information to National Competent Authorities Pre-application for Internal Models.

    - Individual EU regulators are expected to comply with the guidelines, beginning in 2014.

9. INDUSTRY BENCHMARKING

This section of the report focuses on eight core industries, seeking to shed light on the changes, challenges, and trends facing these industry captive owners over time, and what the future of captive use may look like.

9.1 ALL INDUSTRIES COMBINED

The longstanding trend of certain industries being the heaviest users of captive insurance arrangements continued in 2012: Financial institutions, health care, retail and consumer products, and manufacturing were at the top of a list of 20 industries that use captives (see Figure 24). These four industries accounted for 54% of all captives globally.

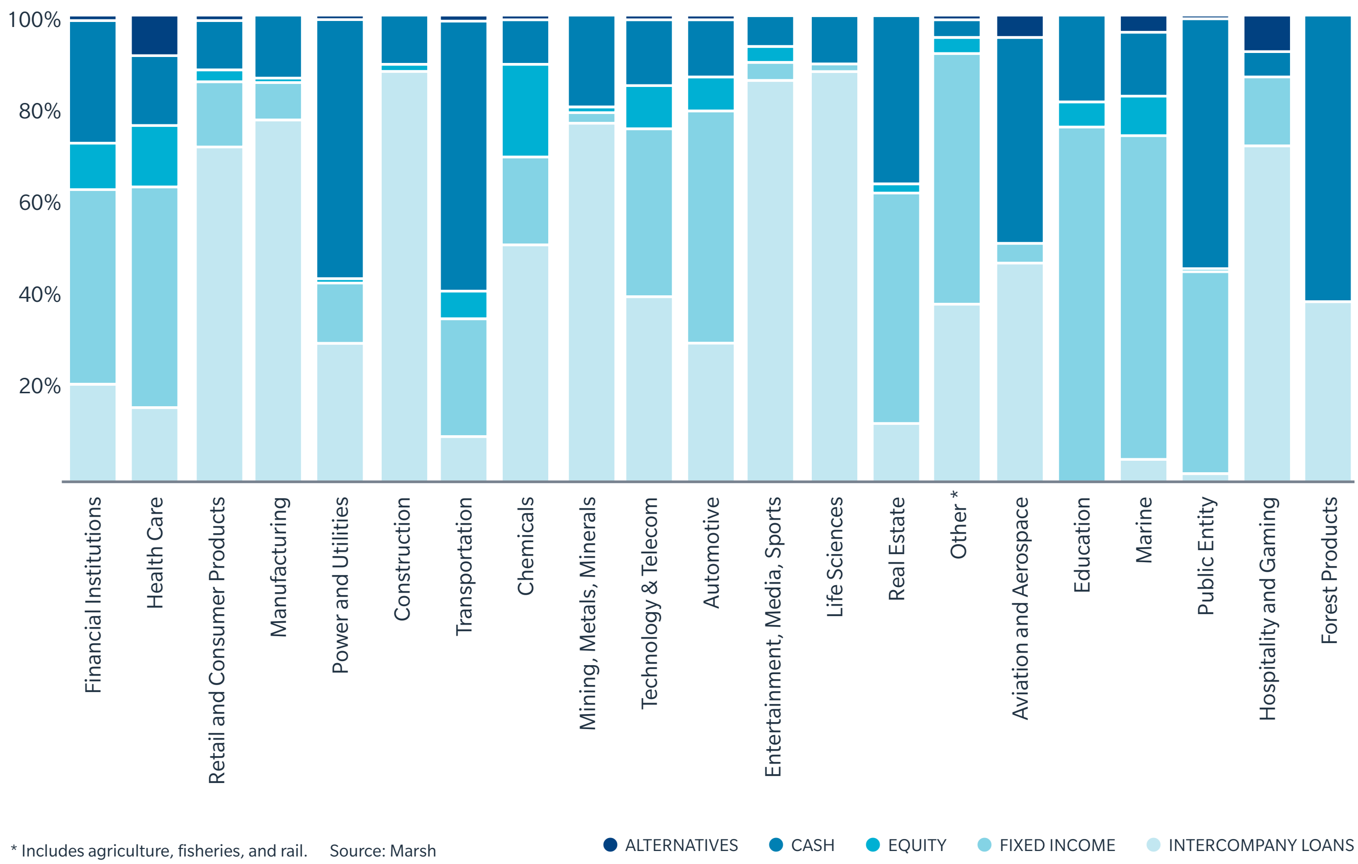
FIGURE 24: CAPTIVE USE BY INDUSTRY

RANK	INDUSTRY	PERCENTAGE
1	Financial Institutions	18.6%
2	Health Care	17.2%
3	Retails and Consumer Products	9.1%
4	Manufacturing	8.9%
5	Power and Utilities	6.9%
6	Construction	6.4%
7	Transportation	6.2%
8	Technology and Telecom	3.7%
9	Chemicals	3.3%
10	Mining, Metals, Minerals	3.2%
11	Automotive	2.6%
12	Entertainment, Media, Sports	2.3%
13	Life Sciences	2.1%
14	Real Estate	2.1%
15	Aviation and Aerospace	1.4%
16	Education	1.0%
17	Public Entity	1.0%
18	Marine	0.9%
19	Hospitality and Gaming	0.6%
20	Forest Products	0.3%
21	Other	2.0%

Source: Marsh

Among the 20 industries that use captives, there was a wide range of investment strategies used in the captive investment portfolio (see Figure 25).

FIGURE 25: CAPTIVE INVESTMENT PORTFOLIO BY INDUSTRY

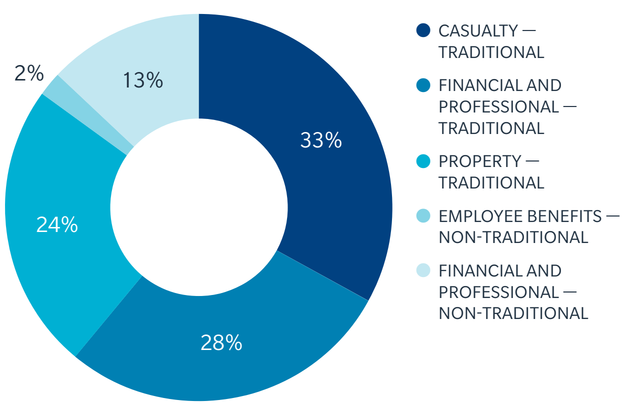


* Includes agriculture, fisheries, and rail. Source: Marsh

9.2 FINANCIAL INSTITUTIONS

The graph below shows the split of the financial institutions (FI) captives underwriting financial product lines, such as errors and omissions (E&O) liability, directors and officers (D&O) liability, crime, fiduciary, and cyber liability. This split could be explained by the fact that financial institutions face various types of financial exposures. In general, an FI's risk profile is defined more by professional liability events. FIs are also comfortable taking large financial and professional liability retentions and retaining losses, or using a captive to access reinsurance markets excess of significant retentions. FIs also write third party customer business.

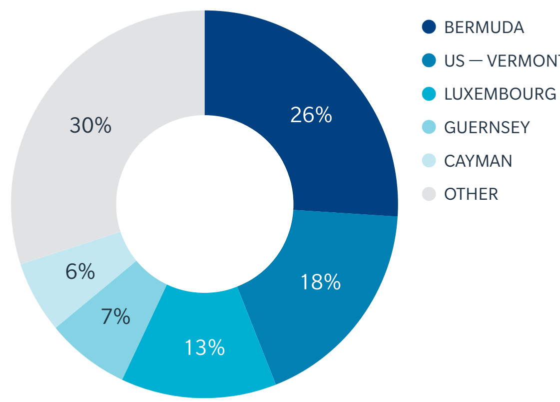
FIGURE 26: FINANCIAL INSTITUTIONS – LINES OF BUSINESS



Source: Marsh

FI captives tend to be based in Bermuda (see Figure 27), with Vermont following. Both domiciles are mature locations that offer a stable regulatory environment. However, in the EU, Luxembourg is attractive to FIs because of the unique equalization reserves that captives can benefit from for efficient economic advantages. The other domiciles for FIs are Barbados, Dublin, Malta, Hawaii, South Carolina, and New York.

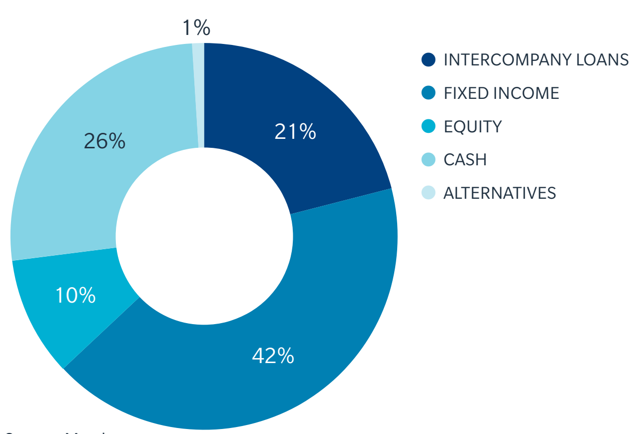
FIGURE 27: FINANCIAL INSTITUTIONS – DOMICILE POSITION



Source: Marsh

FIs are conservative by nature, which explains why these captives tend to be invested in fixed income and cash (see Figure 28). For FI captives investing in intercompany investments, this allows FI treasurers and CFOs to fully control the captive's cash, maintain investment portfolios, and potentially include the captive's cash in FI global cash pools.

FIGURE 28: FINANCIAL INSTITUTIONS – TYPE OF INVESTMENT



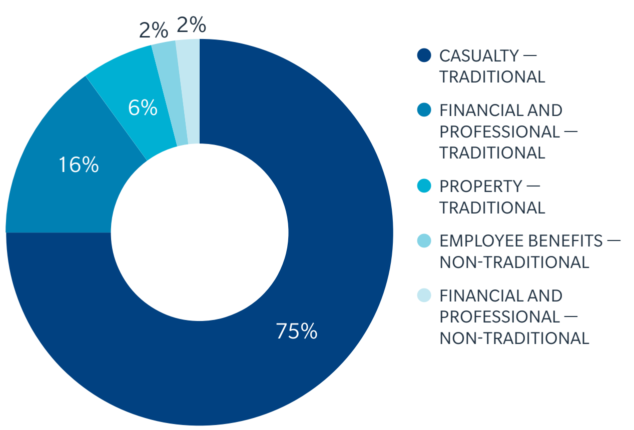
Source: Marsh

9.3 HEALTH CARE

Health care captives predominately write medical malpractice and professional liability coverage (see Figure 29). Managed care organizations are experiencing a resurgence in captives to address various aspects of the new environment created by the Affordable Care Act (ACA). The ACA is having an impact on:

- Health care providers that are seeking affiliations and mergers, which create the critical mass needed to form single-parent or group captives.
- Managed care payers that are finding novel uses for captives.
- Physician practices that are merging to create larger, more efficient physician practices to meet the economic stresses of the new reimbursement environment created by ACA. Their larger size now gives them the premium volume to create their own captive insurers and risk retention groups.

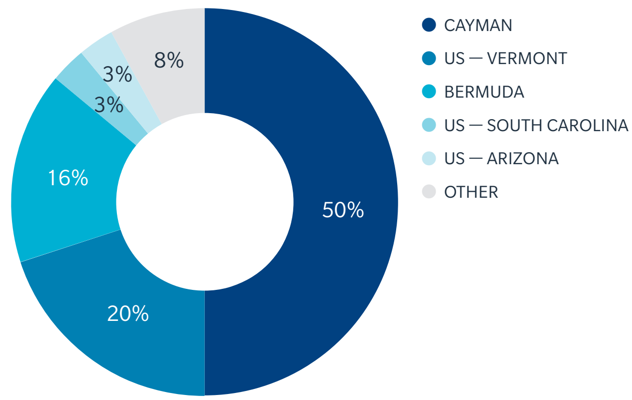
FIGURE 29: HEALTH CARE – LINES OF BUSINESS



Source: Marsh

Health care captives traditionally have been domiciled in the Cayman Islands, with half of all health care captives located there (see Figure 30).

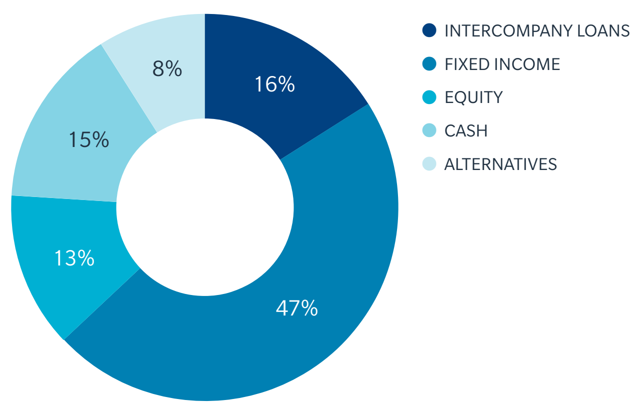
FIGURE 30: HEALTH CARE – DOMICILE POSITION



Source: Marsh

From a conservative investment profile, close to 50% of health care captives are invested in fixed income (see Figure 31).

FIGURE 31: HEALTH CARE – TYPE OF INVESTMENT

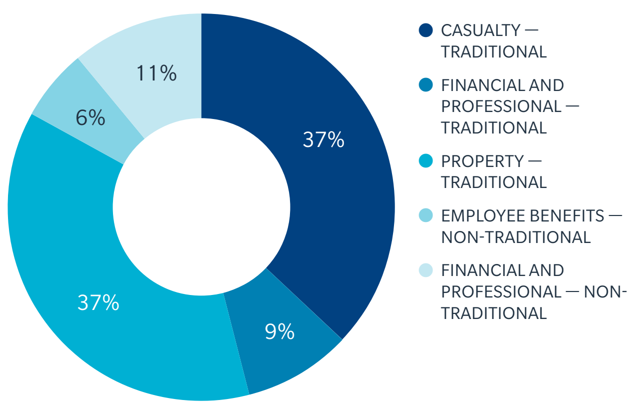


Source: Marsh

9.4 RETAIL AND CONSUMER

From a coverage perspective, retail and consumer captives primarily insure short-tail risks such as property damage and business interruption (typically retail stores and distribution centers, stock, marine cargo and inland transit risks) and casualty risks (see Figure 32). In the US, retailers also commonly insure workers' compensation deductibles. Retailers do use captives to insure longer-tail risks such as general liability, product liability, and automobile liability, but generally to a lesser extent than for short-tail risks. In addition, TRIA in the US is a common coverage for retail captives, as they often have concentrated exposures in cities and locations where a large number of consumers shop. There is also growing interest in insuring cyber and supply chain risk.

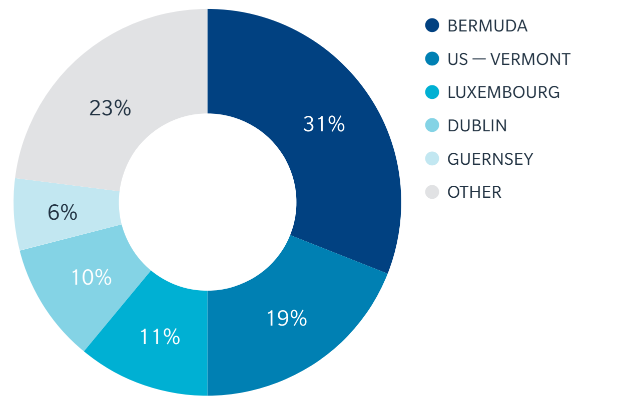
FIGURE 32: RETAIL AND CONSUMER PRODUCTS – LINES OF BUSINESS



Source: Marsh

The domiciles for retail and consumer captives closely mirror the top three domiciles of Bermuda (the top offshore location), Luxembourg (the top EU jurisdiction), and Vermont (the leading Americas domicile) (see Figure 33). Many of the captives in this sector are well established. The other domiciles that retail companies choose are equally split between European, Caribbean, and the Americas domiciles.

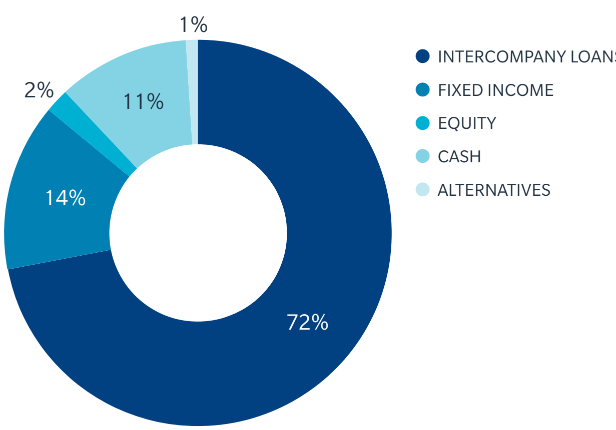
FIGURE 33: RETAIL AND CONSUMER PRODUCTS – DOMICILE POSITION



Source: Marsh

Figure 34 shows that retail and consumer captives are heavily invested in intercompany investments for cash-flow reasons. This industry is consumer-driven and the recession of 2008, coupled with the current marketplace, have created a challenging environment, thereby suggesting that these parent companies prefer access to their captive's cash.

FIGURE 34: RETAIL AND CONSUMER PRODUCTS – TYPE OF INVESTMENT

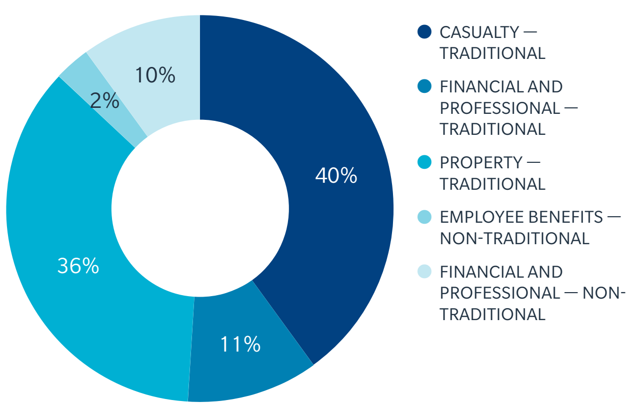


Source: Marsh

9.5 MANUFACTURING

A closer look at manufacturing captives finds an equal split of property and casualty coverages (see Figure 35). This split makes sense considering that manufacturers have significant property values, plants, machinery, and equipment, as well as large work forces, which represent workers' compensation and employment liability coverages. Manufacturers also tend to write the majority of employee benefits (2%) globally because of their large number of employees.

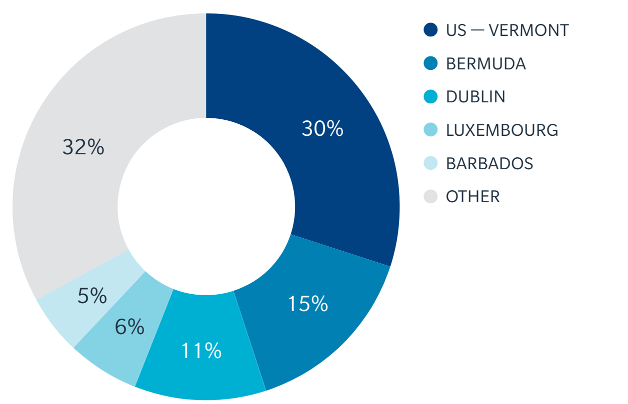
FIGURE 35: MANUFACTURING – LINES OF BUSINESS



Source: Marsh

Manufacturers also have long-established captives that were formed in the top five domiciles globally (see Figure 36). Many manufacturing companies are based in Europe and form EU captives in domiciles such as Dublin, Luxembourg, and Malta. The other domiciles chosen by manufacturers are split relatively evenly between European, Caribbean, and Americas domiciles.

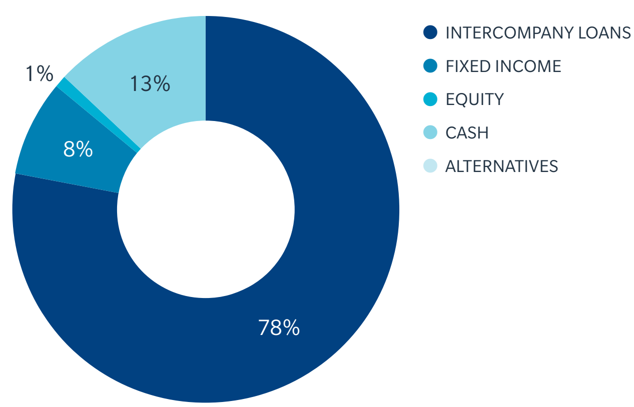
FIGURE 36: MANUFACTURING – DOMICILE POSITION



Source: Marsh

Manufacturers are extremely cash focused, as reflected by the fact that more than 75% of their captive investment portfolios are intercompany investments (see Figure 37). These types of investments allow the parent company to gain access to the captive's cash for operations, acquisitions, and raw materials purchasing power and also provides the captive with a solid return on its investment.

FIGURE 37: MANUFACTURING – TYPE OF INVESTMENT

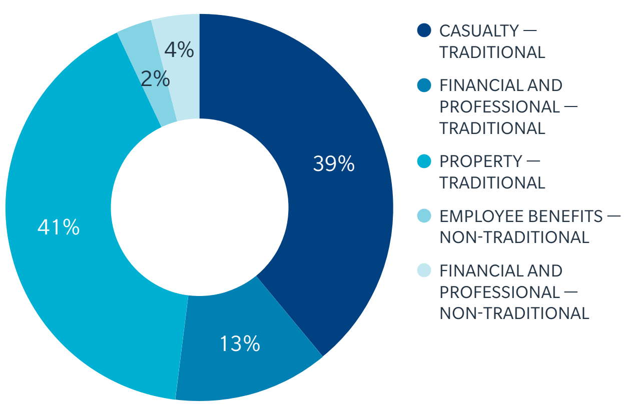


Source: Marsh

9.6 POWER AND UTILITIES

Many power and utilities captives tend to be structured as reinsurance captives, whereby they reinsure a fronting carrier globally for all-risk property coverages (see Figure 38). These power and utilities captives include European and Americas companies.

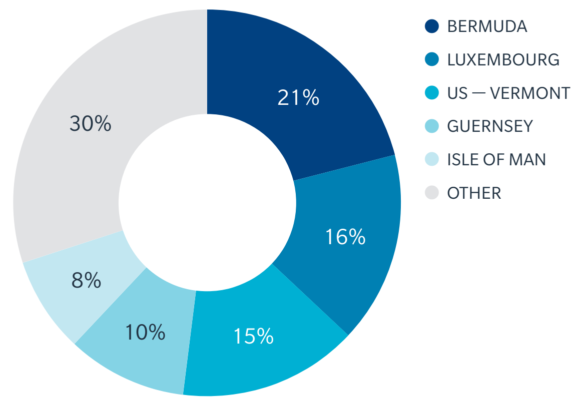
FIGURE 38: POWER AND UTILITIES – LINES OF BUSINESS



Source: Marsh

With the exception of Vermont, power and utilities captives are typically located in non-Americas domiciles, with Bermuda, Luxembourg, Guernsey, and Isle of Man being top choices for this industry (see Figure 39). Barbados, Dublin, Cayman and Dubai are other locations where these captives are domiciled.

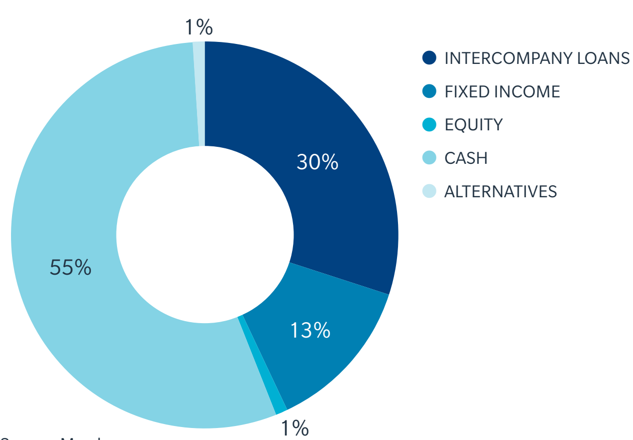
FIGURE 39: POWER AND UTILITIES – DOMICILE POSITION



Source: Marsh

Power and utilities captives are invested primarily in cash, evidence of the fact that there are fronting carriers involved that require significant collateral requirements, which is why more than 50% of assets are in cash/trusts (see Figure 40). In addition, power companies tend to be large and usually very conservative, which further supports this finding. For those companies that are more aggressive, such as some of the opportunistic renewables ones, the second-largest investment category is intercompany investments, suggesting that nearly all industries find it beneficial to access the captive for intercompany loans.

FIGURE 40: POWER AND UTILITIES – TYPE OF INVESTMENT

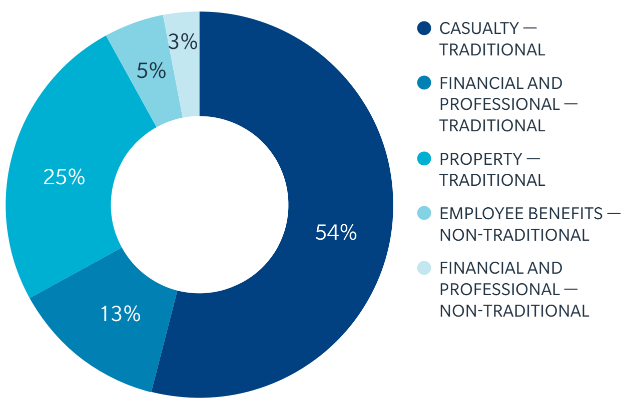


Source: Marsh

9.7 CONSTRUCTION

More than half of construction captives write coverages such as contractor- or owner-controlled insurance programs (CCIP/OCIP) casualty lines, which are workers' compensation and general/completed operations; 25% of construction captives write property and builder's risk coverages (see Figure 41). Other coverages written include construction defect and subcontractor default.

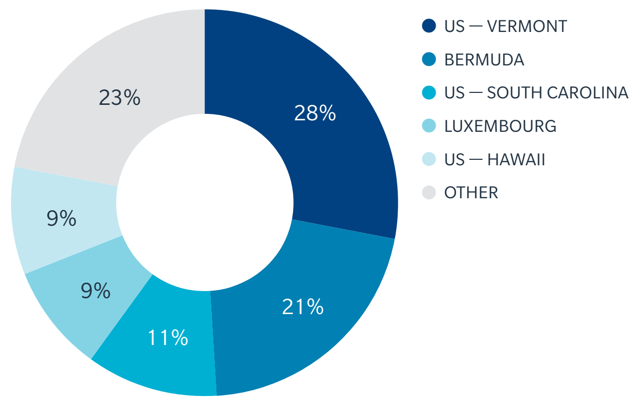
FIGURE 41: CONSTRUCTION – LINES OF BUSINESS



Source: Marsh

Construction captives are global in nature, as can be seen from the wide spread of domiciles (see Figure 42). Hawaii is home to certain captives operating on the West Coast, while other domiciles such as Singapore, Guernsey, and Sweden are also home to construction captives.

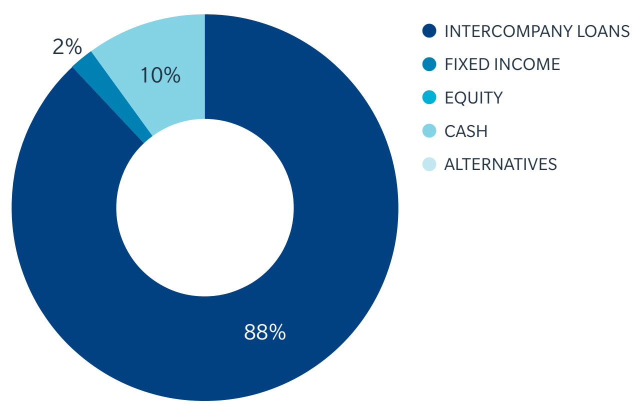
FIGURE 42: CONSTRUCTION – DOMICILE POSITION



Source: Marsh

Construction companies are extremely leveraged and, similar to the retail and consumer industry, were impacted by the economic downturn; therefore these captives are typically heavily invested in intercompany investments (see Figure 43).

FIGURE 43: CONSTRUCTION – TYPE OF INVESTMENT

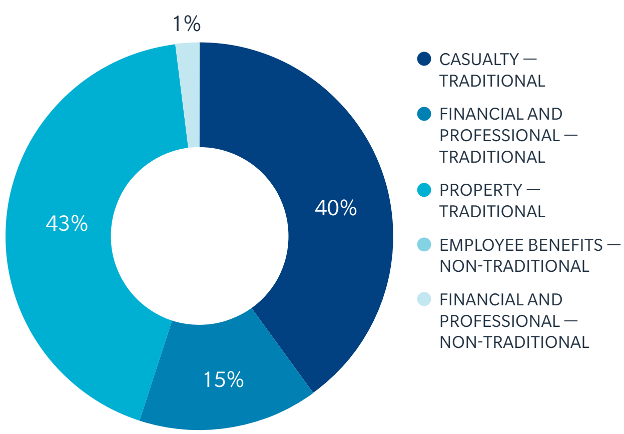


Source: Marsh

9.8 TRANSPORTATION

Transportation captives are equally insuring property and casualty risks in their captives, followed by financial and professional coverages such as errors and omissions and directors and officers (see Figure 44). Large trucking companies, mass transportation, bus companies, and railroads use captives for all spectrums of risk.

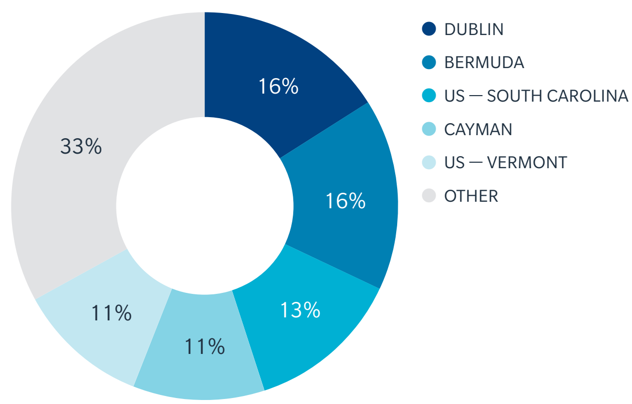
FIGURE 44: TRANSPORTATION – LINES OF BUSINESS



Source: Marsh

Transportation captives are diversified in terms of domicile, with an almost equal split between offshore, onshore, and non-EU domiciles (see Figure 45). Other preferred domiciles include Barbados, Guernsey, Luxembourg, Malta, and Singapore.

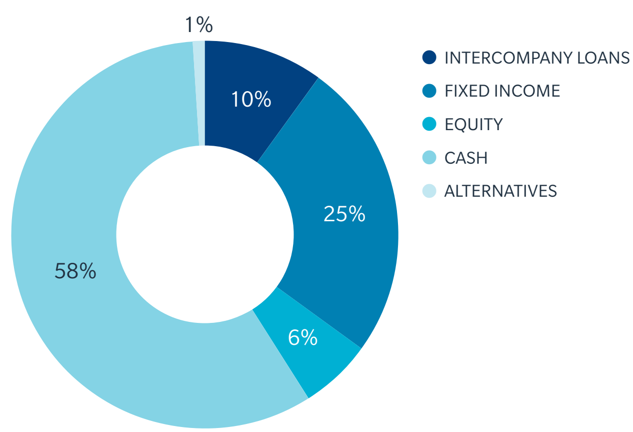
FIGURE 45: TRANSPORTATION – DOMICILE POSITION



Source: Marsh

Since many transportation captives are acting as reinsurance captives, and are reinsuring a fronting carrier globally for property and casualty risks, a significant portion (58%) of their investment portfolio is in cash (see Figure 46), suggesting that cash is being used by the captive to support collateral requirements of the fronting carriers globally.

FIGURE 46: TRANSPORTATION – TYPE OF INVESTMENT



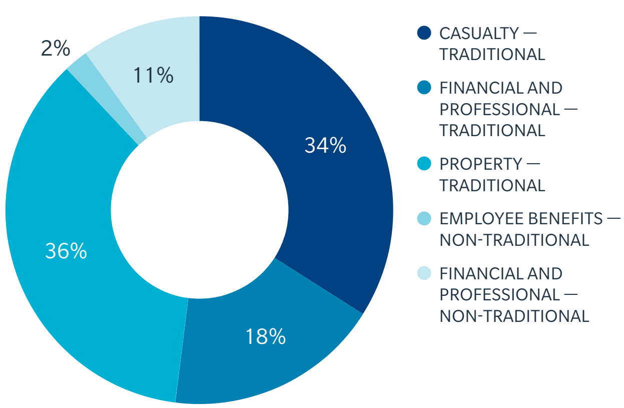
Source: Marsh

9.9 TECHNOLOGY AND TELECOM

The technology and telecom industry uses captives for traditional property and casualty coverages for its own corporate risk (see Figure 47), but there is also a trend toward coverages such as third party risks, employee benefits, terrorism and access to TRIA, product liability, and intellectual property (IP) risk. IP is one of the toughest risks for technology clients to address, as there are no off-the-shelf risk-transfer solutions, and many industrywide initiatives are still trying to get off the ground.

Supply chain resiliency is also a concern for many technology companies. Captives can be a solution to provide coverage where commercial coverage is unavailable or cost prohibitive.

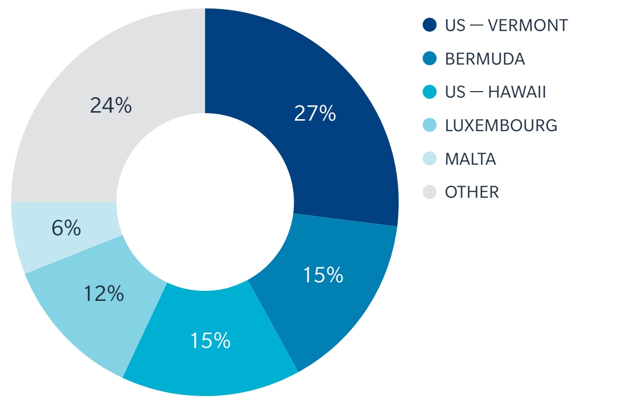
FIGURE 47: TECHNOLOGY – LINES OF BUSINESS



Source: Marsh

Technology and telecom captives are diversified in terms of domicile (see Figure 48). With a heavy presence of technology and telecom companies on both US coasts, the two most established onshore domiciles (Vermont and Hawaii) are logical choices for technology and telecom captive owners, although Bermuda is also a popular choice.

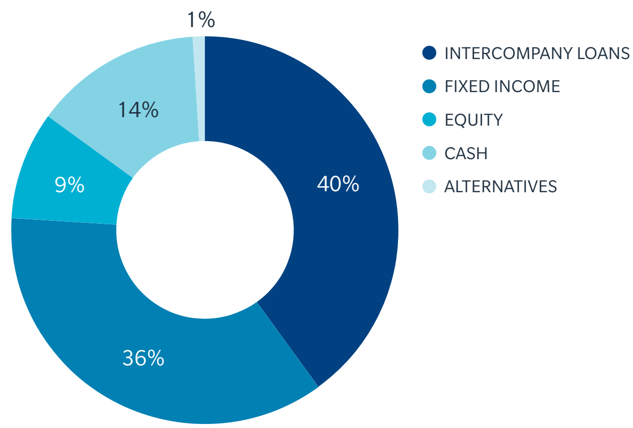
FIGURE 48: TECHNOLOGY – DOMICILE POSITION



Source: Marsh

Technology and telecom captives have a uniquely balanced investment portfolio with slightly more intercompany investments than fixed income (see Figure 49).

FIGURE 49: TECHNOLOGY AND TELECOMM – TYPE OF INVESTMENT

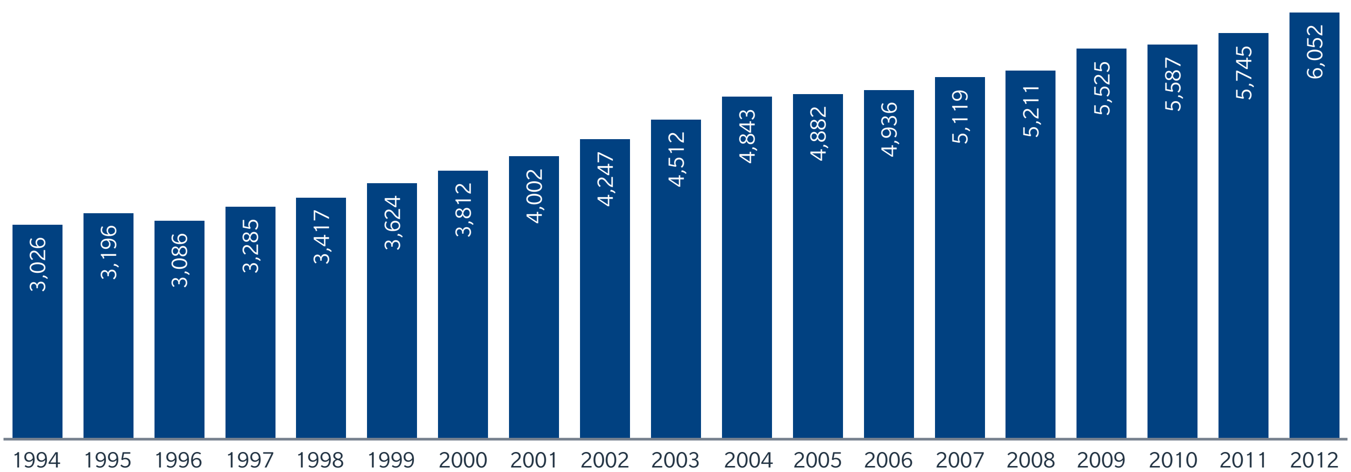


Source: Marsh

APPENDIX

This report is a representation of approximately 886 active captives managed by Marsh, which is approximately 15% of all captives globally (6,052 total global captives). The majority of the data for this report uses Marsh-managed captives, but where noted, we have supplemented certain data points with other industry statistics from sources such as *Business Insurance* and A.M. Best Company.

TOTAL GLOBAL CAPTIVES



Source: Business Insurance

From a geographical perspective, the following sample sizes apply based on the captive's domicile:

CAPTIVE REGION	NUMBER OF CAPTIVES
Americas	631
Europe	212
Asia	37
Australia, Middle East, Africa	6
TOTAL	886

NOTES

ABOUT MARSH

Marsh is a global leader in insurance broking and risk management. We help clients succeed by defining, designing, and delivering innovative industry-specific solutions that help them effectively manage risk. We have approximately 26,000 colleagues working together to serve clients in more than 100 countries. Marsh is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), a global team of professional services companies offering clients advice and solutions in the areas of risk, strategy, and human capital. With more than 53,000 employees worldwide and annual revenue exceeding $11 billion, Marsh & McLennan Companies is also the parent company of Guy Carpenter, a global leader in providing risk and reinsurance intermediary services; Mercer, a global leader in talent, health, retirement, and investment consulting; and Oliver Wyman, a global leader in management consulting. Follow Marsh on Twitter @Marsh_Inc.

ABOUT MARSH'S CAPTIVE SOLUTIONS PRACTICE

Marsh's Captive Solutions Practice includes the Captive Advisory Group, Captive Management Services, and the Captive Solutions Actuarial Group. We have more than 450 colleagues managing more than 1,220 captives globally. In the industry for more than 40 years, we have management offices in 18 countries and advisory expertise in retail brokerage offices worldwide. Captive Advisory is the consulting arm of Captive Solutions. A designated team of expert captive advisors works closely with captive champions in the geographies to deliver best-in-class advice and service from feasibility studies to structuring and implementation of captives. This group is also responsible for training and developing colleagues throughout Marsh to be captive champions and practitioners. Captive Management is an industry leader in designing, implementing, and managing new captives. Once a client has decided to develop a captive, Captive Management can provide the necessary financial, accounting, treasury, and insurance services, from choosing the appropriate location to conducting regulatory filings. Our established relationships with key service providers such as auditors, lawyers, and actuaries helps ensure that each captive runs smoothly, cost-effectively, and with the strategic and financial benefits most appropriate for our clients' businesses. Our Captive Solutions Actuarial Group comprises credentialed actuaries and supporting actuarial analysts. Our actuaries consult exclusively with captive and self-insurance programs in numerous global domiciles.

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