August 7, 2024*

Growing Captive Insurance Market Highlights Risk Management Expertise

From 2019 to 2023, AM Best rated captives generated $4.3B in surplus growth and $2.0B in dividends

Principal Takeaways

- Captive use continues to expand in the persistently hard market through formations, increases in retentions, and inclusion of new lines of coverage.
- Captives are an extension of an organization's enterprise risk management program and a viable alternative to the traditional commercial insurance market, accounting for approximately 25% of all commercial premium globally.
- The underwriting performance of AM Best-rated captives continues to outperform commercial casualty peers.
- From 2019 to 2023, AM Best-rated captives generated an estimated $6.3 billion—$4.3 billion surplus growth and $2.0 billion in dividends—that would otherwise have gone to the commercial market.

The formation and use of existing captive insurance companies provides a viable enterprise risk management (ERM) alternative for companies that understand their own unique risks. When feasible, companies would prefer to get coverage from the commercial market, but where coverage appears overpriced for a company's own perceived risk, captives continue to be a logical alternative.

Typically, companies using captives look to customize their commercial insurance programs to have more decision-making authority and more control over managing these risks. In periods of insurance market hardening, captive-type vehicles can offer an effective and efficient option to support a parent's ERM coverage requirements.

Benefits are especially pronounced in periods of sustained hardening as seen since late 2017. Higher than expected inflation, social inflation, medical inflation, and weather-related claims, primarily secondary perils, have contributed to the market hardening.

The increase in natural catastrophe loss costs prompted reinsurers to address pricing and terms and conditions in their own ERM efforts to fortify balance sheets. Commercial insureds that had the foresight to establish alternatives such as captives or cells benefited by offsetting some of the capacity costs and constraints for their required risks.

Captives, and cells within protected or segregated structures, offer an opportunity for policyholders to tailor specific risks by customizing based on their own loss experience. This helps enterprises manage capital efficiency as captives often outperform the commercial market, coming in with better than modeled costs, flexibility in payouts, and maintaining viable capitalization to cover future losses, as necessary.

The cyber market has generally stabilized (not softened), but rapidly escalating pricing prompted captive owners to contemplate offering higher limits.

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2024-101-080824

Since the pandemic, business interruption has frequently been customized by captive owners to ensure they have some predictable coverage should a future event emerge. Meanwhile, employee benefits coverage is a new opportunity covered in captive arrangements.

AM Best – Alternative Risk Transfer Criteria

AM Best uses Alternative Risk Transfer Criteria for the captives that it rates. The criteria provide specialized guidance for nuance and considerations in rating these entities beyond our broader Best's Credit Rating Methodology for traditional insurance and reinsurance companies.

Business Profiles – A Roadmap to Success

As the hard market has persisted, there has been an uptick in the use of captives among owners, sponsors and managers. The number of US domestic captives grew to 3,365 in 2023 from 3,328 in 2022. **Exhibit 1** lists the active US captive domiciles with 100 or more captive insurers.

The global captive insurers (**Exhibit 2**) represent a diverse range of industries and risk profiles (**Exhibit 3**). In conducting our analysis, it is important to distinguish the context for the company that we are rating.

Business profile is one of the four building blocks in our credit rating process, *Best's Credit Rating Methodology*. In the case of captives (under Alternative Risk Transfer Criteria), that includes the structure of the captive, the lines of business it intends to write, and how or if it will be reinsured after its own retention. The purpose of the captive (and its business owner) is important when evaluating projections and expectations for the captive's operations.

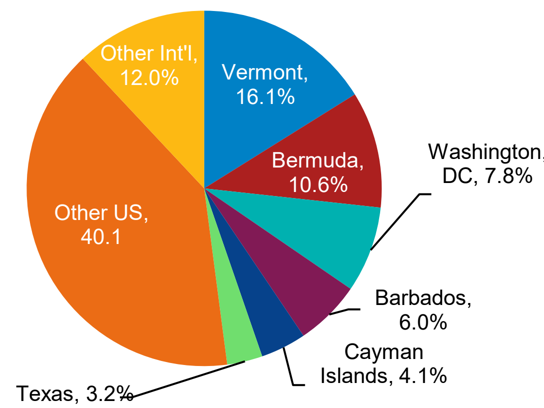
Larger corporations that establish single parent captives (SPCs) typically use them to cover low-frequency, high-severity lines of business related to property and catastrophic (CAT) events. Related risks may also include losses related to business interruption (including strikes and labor issues); pandemics; and inventory/stock throughput. Other potential risks and lines cover directors and officers, professional liability, product liability, cyber, and surety bonds for the benefit of an obligor (policyholder). In a hard market, owners/sponsors often broaden the use of their captives to provide coverage for non-traditional risks such as warranties and service contracts, medical stop loss coverage, and federal terrorism risk.

Exhibit 1
Number of US Captives, 2023

Rank	US Domicile	2023
1	Vermont	659
2	Utah	439
3	North Carolina	311
4	Delaware	289
5	Hawaii	263
6	South Carolina	221
7	Arizona	176
8	Tennessee	162
9	Wash DC	120
10	Nevada	100
11	Montana	100
	Other States	525
	Total	**3,365**

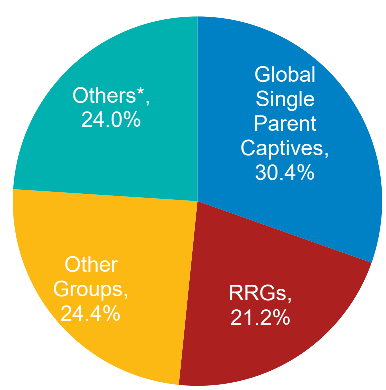
Source: Business Insurance

Exhibit 2
AM Best's Rated Global Captives, by Domicile (2023)



Source: AM Best data and research

Exhibit 3
AM Best's Rated Global Captives, by Type



*Includes: Exchanges, Reciprocals, SIFs, and Cells
Source: AM Best data and research

They may also replace all or a portion of coverage offered with unfavorable terms, such as workers' compensation, general liability, and automobile.

The evolution of captives as risk transfer vehicles has made them accessible to small and medium-sized enterprises (SMEs) in the form of group captives, risk retention groups (RRGs), and protected cell facilities. In group arrangements, the enterprises combine their resources to more efficiently pursue professional insurance risk management and loss control, for more affordable risk-sharing, and for purchasing coverage in both the traditional and reinsurance markets.

Each structure has its own capitalization requirements. Group captives and RRGs typically cover higher-frequency, lower-severity (relative to property/CAT) coverages in a working layer topped by reinsurance. A couple of notable distinctions are that RRGs are not permitted to cover any property (at this point) and do not have access to state guarantee funds since the business they write can include coverage outside their domiciliary state.

Protected cell facilities continue to grow in popularity, as they are faster and more cost-efficient to establish. Further, they can later be converted into a fully licensed captive. Depending on the domicile's captive statute, cell facilities can be formed under a variety of names, such as segregated account company, segregated portfolio company, protected cells, incorporated cells, or series cells (limited liability companies).

Cell facilities use a third-party insurance management and licensing platform to address risk transfers more quickly, with smaller amounts of capital investment, and gain the benefits of professional oversight so they can focus on the specific line of business they are insuring. They are relatively easy to close or suspend if desired and can be restarted quickly while providing access to the reinsurance market for each cell owner. Interest in cell facilities continues to grow due to the flexibility the structure provides. In most of these structures, sponsors provide platforms accessible to cell owners that seek a variety of coverages while carrying no obligation to absorb losses arising from the cells, as the operating agent of the cell platforms. Instead, they collect fees for services rendered, and each cell owner and its policyholder stand on its own with regard to capital and decision-making.

Regardless of the coverage or company type being used, captives continue to play a critical role in providing financial benefits and capacity to buyers of commercial insurance and their stakeholders.

Balance Sheet – Permanent Capital is King

As insurance is a balance sheet business, AM Best's balance sheet strength assessment is the foundation in our credit rating process, where risk-based capitalization is a key component in determining the balance sheet assessment of a rating unit. Captives may differ in covering low-frequency, high-severity losses or working layer retentions in high frequency, low severity claims, so rightsizing the capital to the current and prospective exposures is an objective measure that is highly critical.

Captive owners continue to utilize various methods to ensure their capitalization levels are adequately supported to effectively manage their risks. US captives in the Captive Insurance Composite (CIC) continued their favorable trend in 2023, increasing surplus 16.8% since 2019, and 4.6% year over year, while distributions of nearly $2 billion were returned to captive owners during this same period (**Exhibit 4**).

Owners and sponsors typically fund their captives with cash but other sources of capital may include surplus notes and letters of credit. They may also set up loanback arrangements whereby they drop cash into the captive and borrow it back from the captive, generating capital efficiencies for the entire enterprise. Under a loan agreement, the captive can hold the loan as a demand note in its balance sheet while earning interest from its parent company.

Exhibit 4
US CIC – Policyholders' Surplus (YE 2023)
($ millions)

	2019 PHS	2023 PHS	Increase	Stock and Policyholder Dividends	Total Savings
SPCs	10,992	14,008	3,016	1,525	4,541
RRGs	2,860	3,242	383	121	503
All Other Rated Captives	**11,763**	**12,682**	**919**	**345**	**1,264**
Total Rated Captives	**25,614**	**29,933**	**4,318**	**1,991**	**6,309**

Source: AM Best data and research

Companies generally prioritize the investment risk of their balance sheets for capital preservation ahead of investment returns. AM Best also considers the captive's investment philosophy and management of its capital in our assessment of balance sheet strength.

As investment markets rebounded well in 2023, companies adapted their portfolios to the less volatile, albeit higher, interest rate environment and were able to more confidently deploy investments into better yielding fixed income securities than they had in years.

The prior year, 2022, was unprecedented in investment markets as both fixed income and equity investments performed poorly under inflationary conditions, driven by the rising interest rate environment, causing unrealized losses.

Even with the market rebound in 2023, capital distributions back to the owners, whether in the form of dividends or return of capital contributions, were reconsidered by many captives. RRGs that were negatively impacted by the 2022 adverse markets were more likely than other captives to place a hold on distributions back to their members.

Reinsurance pricing and capacity was also a challenge for many captives in 2023, which resulted in tighter terms and conditions, rising retentions, and higher reinsurance premiums for less coverage on a dollar-for-dollar basis. Captives that offer higher limits for their owners are more likely to be more dependent on reinsurance, which is necessary to cover catastrophes and/or an accumulation of losses in the "tail."

Captives often purchase reinsurance coverage from highly rated reinsurers to mitigate the credit risk associated with reinsurance dependency. To mitigate the pricing challenges from the reinsurance hard market in 2023, many enterprises opted to take less reinsurance coverage by retaining more exposure in their own self-insured retentions or in their captives through increased attachment points, as well as by leaving gaps open in the higher layers. Some captives even considered lowering the limits offered to their owners as a mitigating tool to navigate the reinsurance markets and maintain current capitalization support.

Operating Results – Captive Profitability Consistently Outperforms Traditional Market

For many years now, AM Best-rated captives have outperformed the commercial insurance market in both underwriting and operating profitability.

The exhibits in this section compare the rated US captives in the Captive Insurance Composite (CIC) to companies in the Commercial Casualty Composite (CCC). The five-year average combined and operating ratios before dividends of the CIC substantially outperformed those of CCC by wide margins, as shown by the CIC's combined ratio of 86.0 (vs. 97.5 for the CCC) and 79.6 operating ratio (vs. 86.9 for the CCC) (**Exhibit 5**). This outperformance has led to substantial growth in captives' retained earnings and surplus growth.

The historical drivers of the CIC's outperformance are largely unchanged and include the captives' efficiency in managing and mitigating risk, their ability to control operating costs, and their focused approach to underwriting. Additionally, as self-insurance vehicles, captives are incentivized to focus on loss control and the preservation of capital, as opposed to chasing profitability and higher rates of return.

Although captives are not created with the intention of being profit centers for their organizations, they are highly profitable (**Exhibit 6**). We expect that, barring any unforeseen systemic catastrophic events, captives' results will again be favorable in 2024.

Premium Growth

In 2023, premium growth has returned to the trend prior to 2022 with an increase in direct premiums written (DPW) of 2.6%. Prior to 2022, premiums had been relatively flat, with a compound annual growth rate of just under 2%. This period includes 2020-2022, which were years skewed by a slowdown in economic growth caused by the COVID-19 pandemic. Notably, an increase of 21.5% in net premiums earned in 2023 reversed a trend of single-digit growth seen in the previous four years. Stable premiums have long been a feature of captives, as these companies have more control

Exhibit 5

US CIC – Five-Year Combined Ratios (YE 2023)

(%)

	Combined Ratio (Ex Div)	Operating Ratio
SPCs	72.8	55.4
RRGs	96.7	86.3
All Captives (CIC)	**86.0**	**79.6**
5-Year CCC	**97.5**	**86.9**

Source: AM Best data and research

Exhibit 6

US CIC – Financial Indicators, 2019-2023

($ millions)

Year	Net Premiums Written	% Chg	Pretax Operating Income/ Loss	% Chg	Net Income/ Loss	% Chg	Admitted Assets	% Chg	Loss & LAE Reserves	% Chg	Year End Surplus	% Chg
2019	5,151	5.3	975	-17.0	1,244	14.2	42,134	5.7	9,752	3.3	25,614	5.2
2020	5,205	1.0	851	-12.7	1,109	-10.9	44,045	4.5	10,184	4.4	26,747	4.4
2021	5,426	4.3	683	-19.7	995	-10.2	46,531	5.6	10,535	3.4	28,401	6.2
2022	6,918	27.4	1,488	118.0	923	-7.2	47,947	3.0	10,862	3.1	28,407	-
2023	7,300	5.5	1,542	3.6	1,411	52.9	50,693	5.7	11,255	3.6	29,933	5.4
5 Yr. CAGR		**8.3**						**4.9**		**3.6**		**4.2**
5 Yr. Chg.		**49.2**						**27.1**		**19.2**		**22.9**

Source: AM Best data and research

Exhibit 7

US CIC – Ratio Analysis, 2019-2023

(%)

	Loss & LAE	Underwriting Expense	Combined (Ex Div)	Policyholder Dividends	Net Inv. Ratio	Operating Ratio
2019	64.9	19.5	84.4	17.7	20.7	81.5
2020	68.4	18.9	87.3	11.8	16.4	82.8
2021	66.3	19.2	85.5	14.8	12.8	87.5
2022	64.5	16.4	80.9	4.8	14.4	71.3
2023	73.3	17.9	91.1	6.4	20.2	77.3
5 Yr. Avg. (CIC)	**67.8**	**18.2**	**86.0**	**10.7**	**17.0**	**79.6**
5 Yr. Avg. (CCC)	**68.8**	**28.7**	**97.5**	**0.2**	**10.8**	**86.9**

Source: AM Best data and research

managing and monitoring their risks and setting actuarial pricing. The rise in premiums was due to rate increases reflecting traditional market conditions and stemming from inflationary pressures and the continued hardening of the reinsurance market. Unlike some of their peers in the commercial market, captives have not been materially impacted by the higher frequency or severity of weather and natural catastrophes in the past five years.

Underwriting Results

Underwriting results experienced minimal volatility from 2019 through 2023, except for the most recent year, which saw a deterioration in the combined ratio (**Exhibit 7**). In 2023, the CIC's combined ratio before policyholder dividends saw its largest single year increase in five years, 91.1, up 10.2 points from 2022. The unfavorable results can be attributed primarily to an 8.8-point increase in the loss and loss adjustment expense (LAE) ratio, driven by a 9-point increase in the pure loss ratio and offset slightly by an improvement in the LAE ratio. Furthermore, the underwriting expense ratio worsened by 1.5 points from the prior year, as both commission and other expenses have crept up relative to premium earned (**Exhibit 8**).

In 2023, the policyholder dividend ratio increased approximately two points from 2022. The 6.4 policyholder dividend ratio was the second lowest since 2019. Lackluster operating results in 2023 drove the reduction in dividends, which resulted in pressure on surplus. Dividend payments were down compared to 2019-2021, but higher than in 2022, and are unlikely to have a material impact on member retention levels.

Investment Results

Given that capital preservation is often captives' primary investment objective, these companies maintain highly conservative investment portfolios, which have historically generated investment yields lower than the commercial market. Since 2019, the CIC's return on invested assets (ROIA) has been generally favorable, but fell into negative territory in 2022 due to a downturn

Exhibit 8

US CIC vs. CCC – Underwriting Expense Analysis (YE 2023)

	Commission Expense Ratio		Other Expense Ratio		Total Underwriting Expense Ratio	
Year	**US CIC**	**CCC**	**US CIC**	**CCC**	**US CIC**	**CCC**
2019	2.0	11.9	17.5	17.4	19.5	29.3
2020	1.6	11.6	17.3	17.1	18.9	28.7
2021	2.3	11.6	17.0	16.2	19.2	27.8
2022	2.7	11.9	13.6	15.7	16.4	27.6
2023	3.5	12.1	14.3	15.7	17.9	27.8
5 Yr. Avg.	**2.5**	**12.9**	**15.7**	**15.8**	**18.2**	**28.7**

Source: AM Best data and research

Exhibit 9

US CIC vs. CCC – Profitability Analysis, 2019-2023

(%)

Year	Inv Yield	NII (W/RCG)	Total ROIA	POI/ NPE	NI/ NPE	Total ROR	POI/ PHS	NI/ PHS	Total ROE	Loss & LAE	Under-writing Expense	Operating Ratio
2019	2.8	4.1	6.2	19.4	24.7	39.4	3.9	5.0	7.9	64.9	19.5	81.5
2020	2.1	3.0	3.8	17.1	22.3	28.0	3.2	4.2	5.3	68.4	18.9	82.8
2021	1.6	3.0	4.1	13.0	19.0	26.5	2.5	3.6	5.1	66.3	19.2	87.5
2022	1.9	1.2	-2.1	26.2	16.3	-6.4	5.2	3.2	-1.3	64.5	16.4	71.3
2023	3.2	3.7	5.0	22.3	20.4	28.5	4.1	4.8	6.7	73.3	17.9	77.3
5 Yr. Avg. (CIC)	**2.3**	**3.0**	**3.3**	**19.9**	**20.4**	**22.9**	**4.1**	**4.2**	**4.7**	**67.8**	**18.2**	**79.6**
5 Yr. Avg. (CCC)	**3.5**	**3.6**	**4.1**	**12.1**	**10.3**	**11.5**	**10.9**	**9.2**	**10.3**	**68.8**	**28.7**	**86.9**
10 Yr. Avg. (CIC)	**2.4**	**3.1**	**3.2**	**23.9**	**23.1**	**23.8**	**5.0**	**4.8**	**5.0**	**65.1**	**18.9**	**76.1**
10 Yr. Avg. (CCC)	**3.6**	**3.9**	**4.0**	**12.2**	**10.9**	**11.1**	**10.1**	**9.0**	**9.2**	**69.3**	**29.3**	**87.0**

RCG = Realized capital gains

Source: AM Best data and research

in the equities markets and rising interest rates (**Exhibit 9**). In 2023, there was a return to favorable results, with a 5% return on invested assets reflecting $188 million in realized gains and $555 million in unrealized capital gains, due partly to recovery in the equity markets.

Captives continue to benefit from good cash flows and solid net investment income (NII), which is what allows this composite to post better than average operating ratios each year. The average operating ratio over the last five years was 79.6 compared to 86.9 for the CCC. In 2023, NII rebounded nicely, increasing by nearly 71%, marking the second consecutive year of growth after declining in the persistently low interest rate environment prior to 2022. The improvement in NII can be attributed in part to rising interest rates on newly issued fixed-income securities.

SPCs Generate Better Operating Results, Albeit with Volatility

Reported earnings of the SPC composite companies grew 13% in 2023 due to another solid year of underwriting results, enhanced by strong net investment income, although realized capital gains have been limited **(Exhibit 10)**. SPCs have been consistently profitable for their organizations, generating operating ratios of 55.4 on average over the 2019-2023 period **(Exhibit 11)**. An integral factor of the SPCs' historical success has been their deep understanding of their policyholders' risks (i.e., their own loss data), which allows the SPCs to quickly implement loss mitigation strategies when necessary to minimize policyholders' losses in the future.

Growth in SPCs can be measured not just by how much surplus has grown, but also by the amount of dividends they pay their parents. In the five years ending 2023, the surplus of rated US-domiciled

Exhibit 10

SPC Composite – Financial Indicators, 2019-2023

($ millions)

Year	Net Premiums Written	% Chg	Pretax Operating Income/ Loss	% Chg	Net Income/ Loss	% Chg	Admitted Assets	% Chg	Loss & LAE Reserves	% Chg	Year End Surplus	% Chg
2019	1,919	3.6	1,010	19.6	859	23.2	16,643	2.6	3,261	2.6	10,992	3.4
2020	1,960	2.1	888	-12.1	784	-8.7	17,312	4.0	3,247	-0.4	11,511	4.7
2021	2,020	3.1	736	-17.1	628	-20.0	18,535	7.1	3,348	3.1	12,494	8.5
2022	3,209	58.8	1,031	40.1	840	33.9	21,283	14.8	3,330	-0.5	13,563	8.5
2023	3,427	6.8	1,203	16.7	953	13.4	22,154	4.1	3,541	6.3	14,008	3.3
5 Yr. CAGR		**13.1**						**6.4**		**2.2**		**5.7**
5 Yr. Chg.		**85.0**						**36.6**		**11.5**		**31.8**

Source: AM Best data and research

Exhibit 11

SPC Composite vs. CCC – Profitability Analysis, 2019-2023

(%)

Year	Inv Yield	NII (W/ RCG)	Total ROIA	POI/ NPE	NI/ NPE	Total ROR	POI/ PHS	NI/ PHS	Total ROE	Loss & LAE	Under-writing Expense	Operating Ratio
2019	3.2	3.6	3.7	54.1	46.0	46.5	9..3	7.9	8.0	62.3	11.1	48.5
2020	2.0	2.5	2.6	49.3	43.5	43.6	7.9	7.0	7.0	59.3	9.0	51.6
2021	0.9	1.2	1.3	38.8	33.1	33.6	6.1	5.2	5.3	61.6	9.0	62.7
2022	1.7	1.7	1.3	49.4	40.3	37.2	7.9	6.4	6.0	54.6	7.9	48.5
2023	3.7	3.8	3.8	37.9	30.0	30.3	8.7	6.9	7.0	74.8	8.7	62.0
5 Yr. Avg. (SPC)	**2.3**	**2.6**	**2.5**	**44.9**	**37.5**	**37.2**	**8.0**	**6.7**	**6.6**	**63.9**	**9.0**	**55.4**
5 Yr. Avg. (CCC)	**3.5**	**3.6**	**4.1**	**12.1**	**10.3**	**11.5**	**10.9**	**9.2**	**10.3**	**68.8**	**28.7**	**86.9**

RCG = Realized capital gains.

Source: AM Best data and research

Exhibit 12
RRG Composite – Financial Indicators, 2019-2023
($ millions)

Year	Net Premiums Written	% Chg	Pretax Operating Income/ Loss	% Chg	Net Income/ Loss	% Chg	Admitted Assets	% Chg	Loss & LAE Reserves	% Chg	Year End Surplus	% Chg
2019	835	9.9	129	17.1	172	74.1	5,524	8.5	1,715	4.2	2,860	11.3
2020	918	10.0	131	1.6	174	1.2	5,949	7.7	1,824	6.4	3,079	7.7
2021	983	7.1	120	-8.8	181	3.8	6,436	8.2	1,959	7.4	3,242	5.3
2022	1,046	6.4	108	-10.3	36	-80.0	6,397	-0.6	2,167	10.6	2,912	-10.2
2023	1,150	9.9	163	52.0	172	375.7	6,959	8.8	2,324	7.2	3,242	11.4
5 Yr. CAGR		**8.7**						**6.4**		**7.2**		**4.8**
5 Yr. Chg.		**51.4**						**36.6**		**41.3**		**26.2**

Source: AM Best data and research

Exhibit 13
RRG Composite vs. CCC – Profitability Analysis, 2019-2023
(%)

Year	Inv Yield	NII (W/ RCG)	Total ROIA	POI/ NPE	NI/ NPE	Total ROR	POI/ PHS	NI/ PHS	Total ROE	Loss & LAE	Under-writing Expense	Operating Ratio
2019	2.7	4.2	7.7	15.9	21.2	38.8	4.8	6.3	11.6	70.0	26.9	84.1
2020	2.4	3.6	5.9	15.1	20.0	31.5	4.4	5.9	9.2	71.0	24.4	84.1
2021	2.1	3.6	3.7	12.6	18.9	19.9	3.8	5.7	6.0	70.2	25.1	87.6
2022	2.2	1.1	-6.2	10.7	3.6	-30.6	3.5	1.2	-10.0	76.0	21.7	88.8
2023	2.9	3.6	5.8	14.8	15.6	26.2	5.3	5.6	9.4	73.9	24.1	86.2
5 Yr. Avg. (RRG)	**2.5**	**3.2**	**3.2**	**13.7**	**15.5**	**16.0**	**4.3**	**4.9**	**5.1**	**72.4**	**24.3**	**86.3**
5 Yr. Avg. (CIC)	**2.3**	**3.0**	**3.3**	**19.9**	**20.4**	**22.9**	**4.1**	**4.2**	**4.7**	**67.8**	**18.2**	**79.6**
5 Yr. Avg. (CCC)	**3.5**	**3.6**	**4.1**	**12.1**	**10.3**	**11.5**	**10.9**	**9.2**	**10.3**	**68.8**	**28.7**	**86.9**

RCG = Realized capital gains.

Source: AM Best data and research

SPCs increased by nearly a third, to $14 billion, even after nearly $1.5 billion in dividends. The SPCs retained close to $4.5 billion for future losses that would otherwise have been forfeited to the commercial market's profits.

RRG Results Weaken Due to Higher Expenses

In 2023, the net income of the RRG composite returned to levels prior to the drop observed in 2022 (**Exhibit 12**), owing largely to an increase in other income and net investment income, bolstered by a recovery in realized capital gains. This is despite weaker underwriting results year over year (**Exhibit 13**). Underwriting results (combined ratio before dividends) deteriorated moderately in 2023 due to an increase in the expense ratio, partially offset by an improvement in the loss and LAE ratio.

The pure loss ratio deteriorated 5.1 points year over year given that most of the segments covered in the space had experienced more pure losses year over year, although LAE itself eased. Driving these overall developments are social inflation and rising legal costs related to litigation settlements continuing to impact claims severity for RRGs writing in all segments, as well as an increase in frequency in segments like allied lines and fire. Increases in combined and expense ratios could indicate a level of pricing inadequacy that RRGs have some flexibility to correct even if it is through policyholder dividend adjustments.

Social Inflation and Litigation Financing

Despite captives remaining disciplined in their claims management practices, the continuation of social inflation and litigation financing could impact their operating performance.

Social inflation, including jury awards and litigation costs, continues to rise, affecting loss costs. As noted previously, captives are not immune to these inflationary pressures driving up claim costs. For example, social inflation and rising legal costs relating to litigating accident settlements have impacted claims severity for those RRGs that write commercial auto coverages.

Also noteworthy is the evolution of litigation financing, in which third-party investor groups provide up-front financing to plaintiff attorneys involved in personal injury and liability litigation in return for a share in the ultimate jury award or settlement. Litigation financing has become a significant factor in mass tort litigation and can be a major contributor to the lengthening of claims settlement periods and costly verdicts.

Opportunities and Challenges for Captive Insurers

Captives continue to be a tool used by enterprises to drive efficiencies in managing risks. AM Best has observed greater use of captives in response to commercial market conditions, with expansion into new lines of business, as well as increased participation on existing coverages.

Cyber

Cyber attacks have increased exponentially in recent years and cyber insurance is a coverage no company can afford to do without. As these risks morph in terms of type and size, losses from these risks can be crippling to some organizations and remains a growing concern for all organizations, regardless of size or industry.

Despite the recent stabilization in pricing for cyber insurance over the past 12 months, many corporations are either including cyber in their captives or are considering the same. AM Best expects this trend to continue. For SPCs, bringing cyber into the program allows the organization to align the interests of both parties. The parent and captive work closely with each other to develop a cyber security plan, inclusive of insurance, risk mitigation, and loss prevention techniques, as well as a means to improve the organization's overall cyber hygiene. Having cyber as part of the captive also ensures policies, procedures, and controls are in place. SPCs also can provide flexible and customized coverages that may not be easily accessible in the commercial market. Additionally, some captives use third-party technology and cyber consultants to help with underwriting, monitoring, and testing. A growing number of parent organizations have found it beneficial to allow their captive to include a layer of cyber coverage in its program, generating what may be substantial savings to the enterprise.

Employee benefits

To help parent companies manage healthcare costs, reduce fixed expenses, protect against rate volatility, and minimize the impact of catastrophic claims, there has been growing interest in captives covering employee benefit risks, most notably medical stop loss and medical cost containment coverages. By using its captive for these exposures, an organization may obtain greater control over these risks with the added benefits of diversifying the captive's book of business and retaining underwriting profits previously absorbed by a third-party carrier.

One of the fastest growing coverages considered by captives (except RRGs) is group medical stop-loss coverage due to increased medical inflation and the continued rise in healthcare insurance costs, particularly in the US. Parent companies are shifting to SPCs for medical employee benefits coverage, whereby the parent self-insures its medical program and the captive reimburses the parent for aggregate claims exceeding an agreed-upon attachment point. An RRG can also form a parallel group structure for this coverage.

Property

High commercial property rate increases reflect significant catastrophe and secondary peril loss activity, as well as rising property values, tighter reinsurance terms and conditions, and higher ceded rates-on-line. In addition, economic inflation remains elevated, exhibiting supply chain disruptions and increased commodity and labor costs. Given these challenges, there is heightened interest in using captives for property cover, including catastrophe, and some organizations are using captives to address capacity issues and fill gaps, even if only temporarily, in their property tower. In addition, deductible reimbursement policies and deductible buy-down policies are being written within some captives as a strategic risk management solution.

Parametric Contracts

In AM Best's conversations with rated captives and their sponsors, there is growing interest in parametric risk transfer tools. Parametric insurance (commonly known as non-indemnity triggers) is distinguished from traditional insurance (indemnity triggers) in two ways: proceeds paid are a (1) stipulated amount that becomes payable when (2) a loss event occurs and a threshold in the parametric trigger is reached. Similar to SPCs participating in their parent's cyber program, SPCs may have an advantage when it comes to parametric contracts as they are technically an "insider," close to the parent's daily operations and risk mitigation strategies.

Regulators in some jurisdictions have found the use of parametric contracts as an acceptable risk management tool and have introduced legislation related to parametric coverages. For example, in 2023, Connecticut Governor Ned Lamont signed Public Act 23-15, legislation designed to permit captives to engage in parametric contracts. Governor Lamont stated in a June 23, 2023, press release: "This innovative approach offers businesses coverage for unique and hard-to-place risks. Parametric insurance contracts offer certainty for planning purposes as they will pay out a predetermined amount based on the intensity or occurrence of a specific event. This concept provides businesses with a more efficient and customized method to mitigate risks that are uncommon or challenging to insure through the traditional commercial market."

In 2022, the Vermont legislature passed a bill containing several updates to the state's captive insurance law, one of which was to allow captive insurance companies to enter parametric risk transfer contracts. Subsequently, in May 2024, Governor Phil Scott signed Bill H:659, updating the previous bill to alter the language concerning parametric policies. The enacted bill defines parametric policies as "insurance" contracts and allows for different parametric contract structures. The changes in the law are meant to ensure the state's captive rules are not overly prohibitive. The developments in Connecticut and Vermont may generate interest in other states.

Directors & Officers – Side A

Before December 2021, captives were not allowed to provide Side A directors' and officers' coverage to the parent organization in instances where corporations were unable to indemnify these individuals and their assets in the event of a lawsuit. Given this limitation, corporations purchased their D&O coverage from commercial carriers against such lawsuits.

In February 2022, Delaware became the first US state to enact a bill that now allows captive insurers to write this coverage and fund the risk for the benefit of its directors and officers. Subsequently, in October of 2023, Delaware issued guidance for corporations intending to form and operate a Delaware captive for the purpose of providing this coverage; however, take-up in Delaware has been slow thus far. In addition, in early 2023, Senate Bill 620 was passed out of the Oklahoma Senate Judiciary Committee, allowing captive insurance companies to insure Side A D&O insurance coverage for Oklahoma corporations.

Reinsurance

The persistently hard reinsurance market poses some challenges for captives that rely heavily on reinsurance capacity. Catastrophic losses and inflationary concerns have forced price increases over several years, even for captives with favorable claims history. In addition, tighter terms and conditions prevail with reinsurance carriers. Even though capacity has remained available for captives, many have adjusted their programs or increased their retentions. Although AM Best notes that most captives have longstanding relationships with their reinsurance partners, AM Best expects reinsurance renewals, in the near term, to remain challenged due to heightened underwriting discipline in the reinsurance market.

IRS's Micro-Captive Regulation

On April 10, 2023, the US Internal Revenue Service issued a proposed regulation that identified certain micro-captive transactions as "listed transactions" and certain other micro-captive transactions as "transactions of interest." The sentiment from the captive community was that the regulation could impose additional administrative, legal, and financial burdens on the captives and may over-regulate certain 831(b)-electing captives by creating loss ratio requirements of 65%, loanback limitations, and 10-year retroactive provisions.

Despite the sentiments from the captive community, the IRS continues to maintain micro-captives on its annual "Dirty Dozen" list of potentially abusive tax arrangements, signaling no change in its stance against captives. The agency has prevailed in all micro-captive Tax Court and appellate court cases decided on their merits since 2017. No new developments on the proposed regulation have been made publicly available.

In a landmark decision, however, a Florida federal jury has ruled in favor of RMC Group in a captive dispute against the IRS. The IRS claimed that RMC's captives were not real insurance companies and accused them of making false statements in connection with fraudulent insurance plans. In the verdict, the jury cleared the group of penalties under Internal Revenue Code Section 6700, which governs the promotion of abusive tax shelters. RMC becomes the first captive manager to prevail against the IRS after the agency previously achieved seven consecutive wins. This may lead to progress in dialogue about compliance in the management of captive insurance companies.

Appendix 1
Single Parent Captives (SPCs)
Ratings as of August 1, 2024

AMB#	Company Name	Long-Term ICR	Balance Sheet Strength Assessment	Operating Performance Assessment	Business Profile Assessment	ERM Assessment
000381	BlueShore Insurance Company	a	Very Strong	Strong	Limited	Appropriate
003564	Zale Indemnity Company	bbb+	Very Strong	Adequate	Limited	Appropriate
003695	British American Insurance Company	a	Very Strong	Adequate	Neutral	Appropriate
003771	Dorinco Reinsurance Company	a	Very Strong	Adequate	Neutral	Appropriate
011309	Bell United Insurance Company	a-	Very Strong	Adequate	Limited	Appropriate
012022	National Telcom Corporation	a-	Very Strong	Adequate	Neutral	Appropriate
014365	Spirit Insurance Company	a	Very Strong	Adequate	Neutral	Appropriate
018869	Centerline Insurance Company	bbb+ u	Very Strong	Adequate	Limited	Appropriate
020959	Fidvest US LLC	a-	Very Strong	Marginal	Limited	Appropriate
021273	C&T Insurance Company	a-	Very Strong	Adequate	Limited	Appropriate
021278	Palms Specialty Insurance Company, Inc.	a-	Very Strong	Adequate	Limited	Appropriate
022608	NiSource Insurance Corporation, Inc.	a	Very Strong	Strong	Neutral	Appropriate
056001	National Guaranty Ins Co of Vermont	a-	Very Strong	Strong	Limited	Appropriate
056744	Sooner Insurance Company	a+	Very Strong	Strong	Neutral	Appropriate
071170	Blue Whale Re Ltd.	a+	Very Strong	Strong	Neutral	Appropriate
071300	Ameriprise Captive Insurance Company	a+	Very Strong	Strong	Limited	Appropriate
071304	Hamilton Insurance Corp.	a+	Very Strong	Strong	Neutral	Appropriate
071307	Catholic Relief Insurance Co of America	a-	Very Strong	Adequate	Limited	Appropriate
072318	Prism Assurance, Ltd.	a-	Very Strong	Adequate	Limited	Appropriate
075701	AES Global Insurance Company	a	Very Strong	Strong	Neutral	Appropriate
076069	Park Assurance Company	a	Very Strong	Strong	Limited	Appropriate
021471	Relsure Vermont, Inc.	a-	Very Strong	Adequate	Limited	Appropriate
021523	PanAsia Reinsurance Inc.	a-	Very Strong	Adequate	Limited	Appropriate
021742	Rodeo Insurance Company	a+	Very Strong	Strong	Limited	Appropriate
000152	American Road Insurance Company	a	Strongest	Adequate	Neutral	Appropriate
011099	Toyota Motor Insurance Company	a	Strongest	Adequate	Neutral	Appropriate
014232	Saturn Insurance Inc.	a-	Strong	Adequate	Limited	Appropriate
020862	Lone Peak Insurance Company	bbb+	Strong	Adequate	Neutral	Appropriate
020916	Riverfront Insurance, LLC	a-	Strong	Adequate	Limited	Appropriate
020964	Pedcor Assurance Company	bbb	Strong	Adequate	Limited	Appropriate
056005	Agrinational Insurance Company	a-	Strong	Adequate	Limited	Appropriate
056427	Tall Pines Insurance Company	bbb	Strong	Adequate	Limited	Appropriate
056604	Vine Court Assurance Incorporated*	a+	Very Strong	Strong	Neutral	Appropriate
072672	Noble Assurance Company*	a+	Very Strong	Strong	Neutral	Appropriate
075149	Queen City Assurance, Inc.*	a+	Very Strong	Strong	Neutral	Appropriate

*Building block assessments shown are that of the company's respective rating unit

Source: BESTLINK

Appendix 2
Risk Retention Groups (RRGs)
Ratings as of August 1, 2024

AMB#	Company Name	Long-Term ICR	Balance Sheet Strength Assessment	Operating Performance Assessment	Business Profile Assessment	ERM Assessment
010704	Paratransit Insurance Co, A Mutual RRG	a	Very Strong	Strong	Limited	Appropriate
010844	Ophthalmic Mutual Insurance Co (A RRG)	a	Strongest	Adequate	Neutral	Appropriate
011054	ALPS Property & Casualty Insurance Co	a	Very Strong	Adequate	Neutral	Appropriate
011230	California Healthcare Ins Co, Inc. A RRG	a	Strongest	Strong	Limited	Appropriate
011431	The Mutual Risk Retention Group, Inc.	a	Strongest	Strong	Limited	Appropriate
012707	Pinnacle Consortium of Higher Ed VT RRRG	a	Very Strong	Adequate	Neutral	Appropriate
071152	Caring Communities, a Reciprocal RRG	a	Very Strong	Strong	Limited	Appropriate
075520	Comm Hosp Alt for Risk Transfer (A RRRG)	a	Very Strong	Strong	Limited	Appropriate
076779	Restoration Risk Retention Group, Inc.	a	Very Strong	Strong	Limited	Appropriate
000740	Minnesota Lawyers Mutual Insurance Co*	a	Very Strong	Adequate	Neutral	Appropriate
010718	OMS National Insurance Company, RRG*	a	Strongest	Adequate	Neutral	Appropriate
011714	Health Providers Insurance Recip, A RRG*	a	Very Strong	Adequate	Neutral	Appropriate
014310	Coverys RRG, Inc.*	a	Very Strong	Adequate	Neutral	Appropriate
014999	COPIC, A Risk Retention Group*	a	Very Strong	Adequate	Neutral	Appropriate
022002	LAMMICO Risk Retention Group, Inc.*	a	Very Strong	Adequate	Neutral	Appropriate
022026	Lone Star Alliance, Inc., RRG*	a	Very Strong	Adequate	Neutral	Appropriate
023087	MLM Risk Retention Group, Inc.*	a	Very Strong	Adequate	Neutral	Appropriate
011221	STICO Mutual Insurance Company, RRG	a-	Very Strong	Adequate	Limited	Appropriate
011238	Western Pacific Mutual Ins Co, A RRG	a-	Strongest	Adequate	Limited	Appropriate
011397	Eastern Dentists Ins Co A Dental Soc RRG	a-	Very Strong	Adequate	Limited	Appropriate
076154	Allied Professionals Ins Co, A RRG, Inc.	a-	Very Strong	Adequate	Limited	Appropriate
076155	Applied Medico-Legal Solutions RRG, Inc.	a-	Very Strong	Adequate	Limited	Appropriate
010807	New York Schools Insurance Reciprocal	bb	Very Strong	Adequate	Neutral	Appropriate
011418	New York Municipal Insurance Reciprocal	a-	Very Strong	Adequate	Neutral	Appropriate
011963	Rural Trust Insurance Company	a-	Very Strong	Adequate	Neutral	Appropriate
014525	Preferra Insurance Company RRG	a-	Very Strong	Strong	Limited	Appropriate
075903	Caregivers United Liability Ins Co RRG	a-	Very Strong	Strong	Limited	Appropriate
014038	Affiliates Insurance Reciprocal, A RRG	a-	Strong	Adequate	Limited	Appropriate
022422	Physicians Insurance RRG, Inc.*	a-	Very Strong	Adequate	Neutral	Appropriate
022619	HPIC Risk Retention Group*	a-	Very Strong	Adequate	Neutral	Appropriate
075375	Titan Insurance Company, Inc., A RRG*	a-	Very Strong	Adequate	Neutral	Appropriate
010768	United Educators Ins, a Reciprocal RRG	a+	Very Strong	Adequate	Favorable	Appropriate
011256	ICI Mutual Insurance Company, a RRG	a+	Strongest	Strong	Neutral	Appropriate
011399	Terra Insurance Company (A RRG)	a+	Very Strong	Very Strong	Limited	Appropriate
010010	American Contractors Insurance Co RRG*	a+	Very Strong	Strong	Neutral	Appropriate
010741	Housing Authority RRG, Inc.*	a+	Very Strong	Strong	Neutral	Appropriate
011056	Preferred Physicians Med RRG, Mut Ins Co*	a+	Very Strong	Strong	Neutral	Appropriate
012419	Alliance of Nonprofits for Ins RRG, Inc.*	a+	Very Strong	Strong	Neutral	Appropriate
014377	NCMIC Risk Retention Group, Inc.*	a+	Very Strong	Strong	Neutral	Appropriate
022292	MICA Risk Retention Group, Inc.*	a+	Very Strong	Strong	Neutral	Appropriate
022383	ProAssurance American Mutual, A RRG*	a+	Very Strong	Strong	Neutral	Appropriate
022390	Doctors Company RRG, a Reciprocal Exch*	a+	Very Strong	Strong	Neutral	Appropriate
014013	MedPro RRG Risk Retention Group*	aa+	Strongest	Strong	Neutral	Appropriate
014146	AttPro RRG Reciprocal RRG*	aa+	Strongest	Strong	Neutral	Appropriate
075492	Natl Independent Truckers Ins Co, A RRG	bbb+	Very Strong	Adequate	Limited	Appropriate
014143	Integris Risk Retention Group, Inc.*	bbb+	Very Strong	Adequate	Limited	Appropriate

*Building block assessments shown are that of the company's respective rating unit
Source: BESTLINK

Appendix 3
Group Captives
Ratings as of August 1, 2024

AMB#	Company Name	Long-Term ICR	Balance Sheet Strength Assessment	Operating Performance Assessment	Business Profile Assessment	ERM Assessment
055019	Raffles Insurance Limited	a	Very Strong	Strong	Neutral	Appropriate

Source: BESTLINK

Appendix 4
Cell Insurance Company
Ratings as of August 1, 2024

AMB#	Company Name	Long-Term ICR	Balance Sheet Strength Assessment	Operating Performance Assessment	Business Profile Assessment	ERM Assessment
020823	Oxford Insurance Companies	a u	Very Strong	Strong	Neutral	Appropriate

Source: BESTLINK

***Updates to the Report**

This report was updated on August 8, 2024, to correct Exhibits 7 and 11.