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Pacific 2024

20th Anniversary
Aon Insights Series

Clarity and Confidence to Act Now

Better Decisions on Risk Capital and Human Capital

Optimising Risk Management with Captive Innovation

20 Years of
Aon Insights Series
Pacific 2024

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Optimising Risk Management with Captive Innovation

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What are we being asked in an evolving world?

What are our clients saying to us?

I want access to long term capacity.

What's new in the market?

I need alternatives to my incumbent insurer.

I pay a lot of premium to the market for little or no return.

With reducing premiums why do I need my captive?

How could I find additional capacity in severe CAT exposed area?

How can I optimise TCoR and captive participation?

How do I make use of my risk bearing capital?

I want to manage the volatility in my captive.

What deductible should I take?

How do I unlock alternative capital?

I don't think the cover I am buying is appropriate or needed.

Settling a claim is a painful and time-consuming process.

I want to increase the use of my captive.

The Captive Business Case

Client Challenges vs Market Trends

Client Challenges

- The 'hard' market has forced organisations to adjust their risk financing strategies, reassessing their risk appetites and how they use insurance capital
- The emergence of these new forms of volatility are impacting the severity profile which means organisations need to recalibrate their financing approach
- Inflation will push limits and coverage requirements for organisations, further pressurising insurance budgets
- Coverage and capacity is becoming problematic for certain industry sectors meaning organisations need to be more flexible in their risk financing arrangements
- Large, complex and multinational clients are looking for alternative capital to supplement that of the conventional market

There is a discrepancy between the risk quality perceived by the insurers and clients' own understanding of their risks

Market Directions

- Despite improving conditions, the insurance market continues to present challenges related to cost, capacity and conditions
- Emerging risks of tomorrow continue to provide issues on insurability (e.g. PFAS, climate risk, etc) on a medium-term horizon
- Most organisations are undergoing significant changes in risk profile with new forms of volatility associated with climate, supply chain and cyber
- The inflationary environment is increasing asset and business interruption values
- CAT exposure in peak zones continues to be scrutinised by insurers

Your Vision, Our Strategy – Guiding Your Success through Expert Advisory

Captive Journey

Transactional Focus

Global Policy Administration

Centralise the issuing of group policies and claims administration

Access Reinsurance

Increase competitive market

Minimise Total Cost of Risk

Optimise group total cost of risk, utilising captive balance sheet

Non-Traditional Risk

Cover business risks that are not viewed as traditional, or attractive for commercial insurers

Leverage Risk Appetite

Act as balancing tank between group and business units

Support Risk Culture

Motivate internal risk management decisions

Build Future Strategy

Captive strength used to unlock future expansion opportunities, whilst covering adverse loss years

Strategic Focus

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Risk Financing Optimisation

Finding the Right Balance Between Risk Retention and Transfer

Three Stage Process

Risk Appetite
Establishes the **risk tolerance and appetite** of an organisation (how much risk **can** they take vs how much risk **should** they take).

Volatility Modelling
Builds a thorough understanding of the **loss volatility** in the insurance portfolio through actuarial modelling based on **loss and exposure data**.

Program Testing
Tests **alternative program structures** by class and in aggregate to minimise the total cost of risk.

Outcomes and Benefits

- Visibility on available risk transfer options in the market
- Ability to test complex program structures including cross-class aggregates and captive participation
- How insurance portfolios respond to these options
- How each option compares to the risk appetite of the organisation
- Gives a better understanding of risk exposure and current program fit
- Measures the economic benefit of the insurance program under typical and stressed scenarios
- Demonstrates a data-driven approach to decision making

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The 4 Families Of Capital

Expanded Market Access for Captives

Direct (Retail) Market

- Transitioning out of hard market conditions
- Return to profit driving competition
- Volatility concerns remain with natural catastrophes or social inflation
- Difference in appetite between “Global Insurers” and “New Insurers”

Global insurers “more willing” to unbundle their network services

Facultative Reinsurance

- More opportunistic
- Abundant short tail capacity but more limited on long tail
- Lower operating costs can lead to competitive pricing
- Collaborative facultative strategies

Treaty Reinsurance

- Large unobtrusive capacity
- Requires a “professional” lead direct insurer to set pricing
- Struggles with long-term arrangements and/or multi-line coverages

Alternative Risk Transfer

- Parametric, Cat Bonds, Structured Solutions, Cross Class Aggregates, Stop Loss, Insurance Linked Securities (ILS)
- ILS historically used for insurance companies
- Parametric is becoming more competitive for corporates

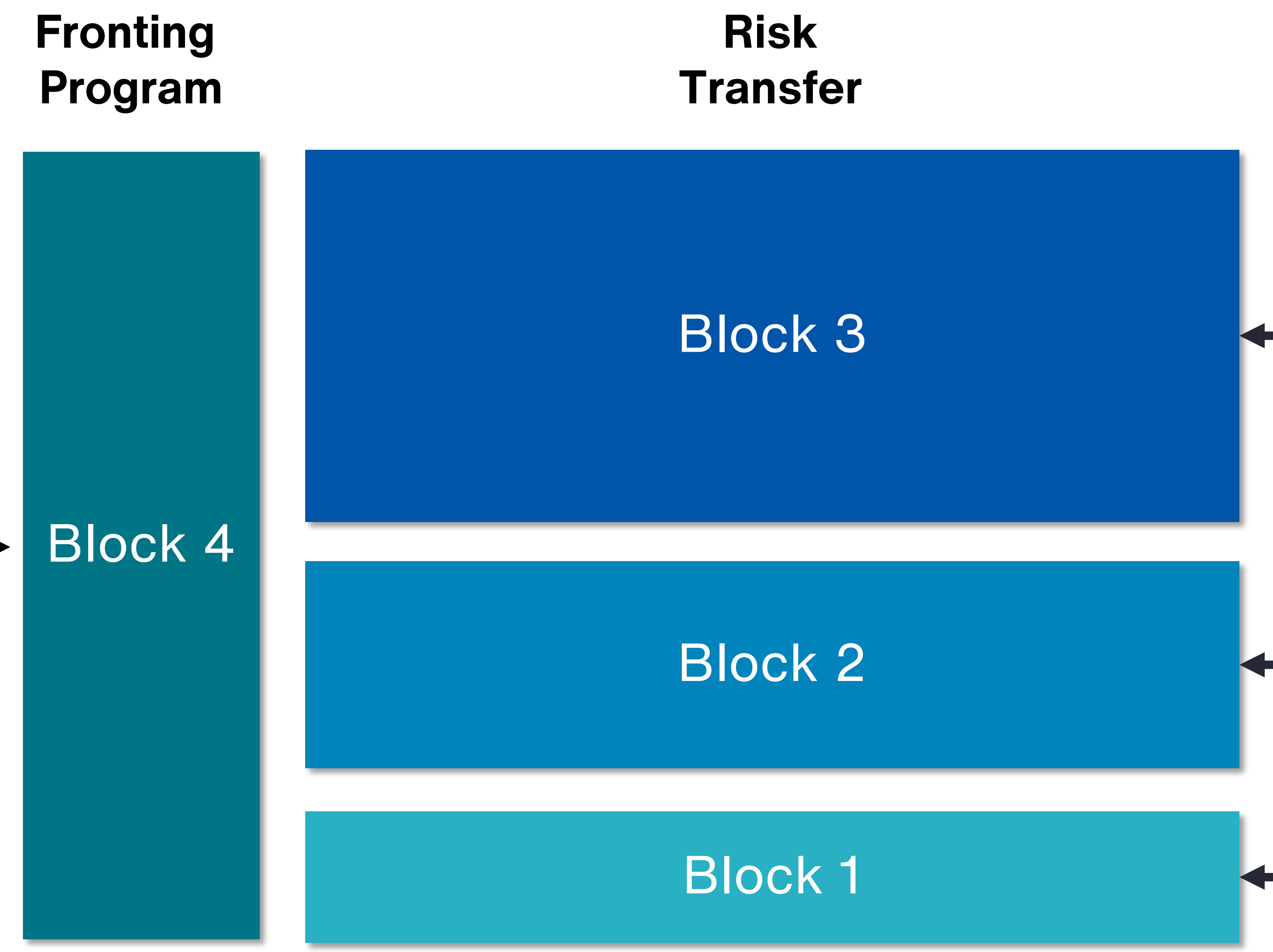
Block Placement Strategy

Optimising risk transfer

Assume a placement is made of four key blocks outlined below – adaptations to each will drive further value

Managing Program

Traditional program lead or pure fronting



Managing Capacity

- Higher attachment point for traditional (re)insurers
- Annual renewal cycle

Managing Volatility – Structured Solution

- Attaching above frequency claims
- Can be reinsurance or insurance
- Increases traditional market attachment point
- Appropriate if layer exposed to catastrophe loss only

Managing Frequency

- Typically, risk retained by a client
- Retentions can flex up or down depending on event or loss type
- Funding can be via balance sheet, cell or captive vehicle
- Stop loss can be considered to protect the volatility

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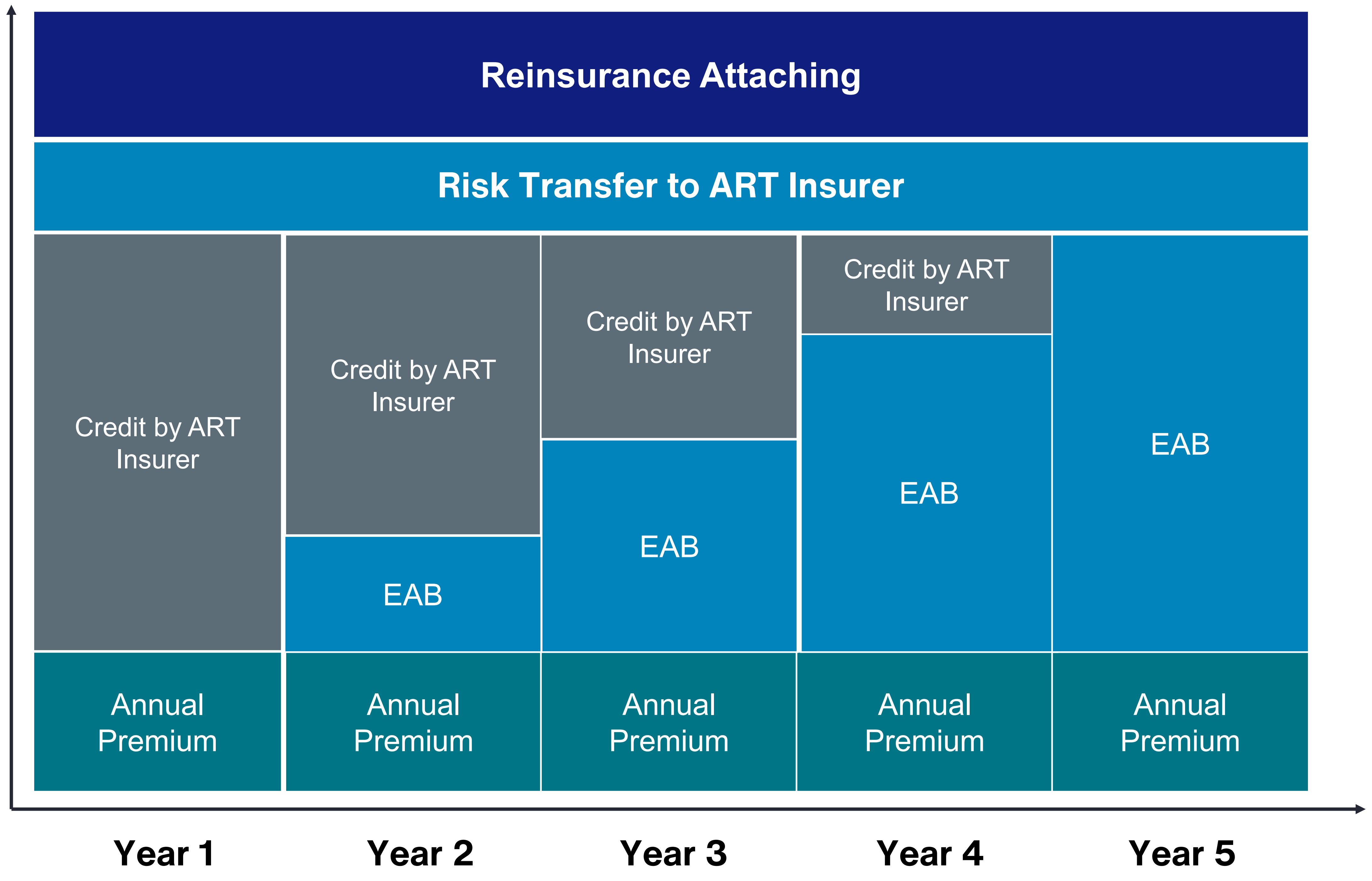
Structured (Re)insurance Solutions

Managing Volatility (Block 2)

How the Concept Works

- A single aggregate limit is purchased over a term (typically three to five years) rather than on an annual basis
- Fixed Annual Premium over a set period made up of an Experience Account Contribution (EAC) and an insurer margin.
- The annual EAC portion builds the Experience Account Balance (EAB) over the term to effectively finance the “first loss”
- Insurer provides cover for second (and subsequent) losses for a premium (insurer margin)
- Insurer also provides cover for timing risk when EAB is not fully funded
- At the end of the period any positive balance held in the experience account (EAB) is returned to the insurer upon commutation



Pros

- Premium smoothing via fixed contract irrespective of claims activity/or market conditions.
- Significant upside in premium if loss experience performs as expected
- Known certainty of premium if claims experience deteriorates - fixed cost
- Efficient purchase of aggregate capacity over annual and term period

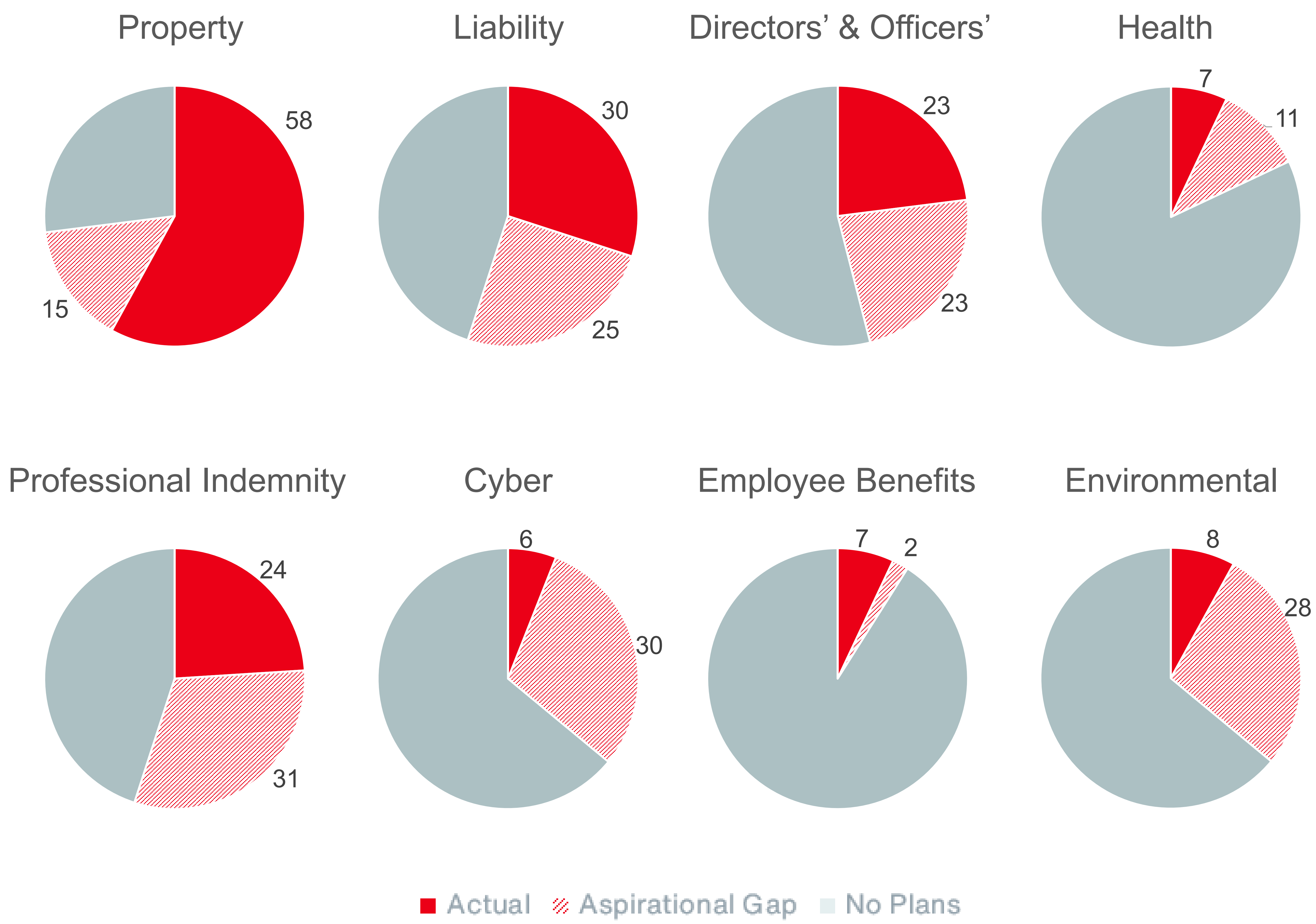
Cons

- Reduced competition for this layer - Allianz ART, AxaXL, Swiss Re, Scor, Arch Re, HDI, Munich Re
- Complexity of impact of annual/term aggregate erosion vs traditional (reinstatement, captive step in or drop-down provision)
- Requires engagement with tax advisors for recognition of profit share
- Tend to work in excess of frequency layer and typically large retention

Captive Optimisation

A journey worth taking

The Aspiration Gap of Captive Utilisation



Sources: Aon Captive Benchmarking Survey and Aon Global Risk Management Survey – Australian Results

Key Takeaways

- Captives form a critical part of an advanced risk management and financing strategy
- Data driven decisions are a critical enabler to unlock and move up the sophistication pathway
- (Re)insurance solutions continue to evolve providing improved purchasing power and enhanced coverage
- Improved utilisation allows for the solving of the mega trends of tomorrow.

Effective captive utilisation is critical to provide greater independence from conventional insurance market cycles

Questions?

Thank You