Strategic Captive Opportunity and Utilization Technique "SCOUT"
and
Next Frontier / Future Enhancements

"A New Method for Measuring Captive Performance" – Risk Management Magazine, 8/1/17

SCOUT

New captive consultative methodology and analytical tool

Improved performance evaluation methodologies

Scoreboard and Dashboard focused

The span of interested **Stakeholders** has expanded over time for various reasons to now include

- Senior Financial Leaders
- Captive Boards
- Operational
- Regulators
- Rating agencies (increasingly)

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SCOUT

Effective tool for risk managers to "translate" risk management information into an understandable format.

Evaluate the benefits, opportunities and performance of a captive insurance company.

Compelling Value Propositions
- Demonstrates Good Governance, Controls and Captive Value to various stakeholders

- Great tool for RMs to Protect Policyholder Surplus

- "It's completely tailored & potentially turnkey"

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Needs

* **Assess how successful / valuable the captive has been according to how the organization measures success**
    – By coverage and over time
    – Managing risk / surplus position
* **Drive business strategies and growth**
* **Evaluate, rank and prioritize current and potential business opportunities**
* **Significantly improve upon current benchmarking and ratio analysis techniques**
* **Identify gaps between actual and targeted performance**
* **Improve decision making via tracking of Key Performance Indicators**
* **Optimize and strategize current and future risk management (programmatic) needs**

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Benefits

- **Make better, faster decisions**

- **Convey meaningful information with simplicity**

- **Illustrate current and future economic benefits**

- **Make the qualitative, quantitative**

- **Deliver a formal process that is consistent and reusable**

- **Enable clear communications across business units, board members, and executives**

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Deliverables / Outcomes

- **Documentation of best practices**

- **Custom Excel application that:**

  - **Captures underlying strategic and tactical considerations via defined KPI metrics ("Scorecard")**

  - **Utilizes an interactive, graphical display for strategic monitoring and reporting of critical needs ("Dashboard")**

  - **Provides a mechanism for addressing forward looking strategic opportunities**

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Scorecard

* **Database to capture underlying strategic and tactical considerations - for existing and potential coverages - via defined Key Performance Metrics ("KPIs")**

    * **Potential quantitative and qualitative KPIs include:**

        – Achieve operational excellence
        – Reduce total costs of risk
        – Build surplus / Maximize risk profile
        – Maximize return on invested capital
        – Improve the risk management function

    * **Defines goal importance and performance ranking metric**

    * **Details / drill-down**

Scorecard Example

		Goal / Objective	KPI Type	Goal Rank	KPI Evaluation	Perf Rank	Response
**Captive Performance Evaluation**   **Policy Year 2016**
**COVERAGE 1**
**1) Operational Excellence**
**A) Insurance Company Operations**
**Underwriting Metrics**
Global Organization Net Premium	1,834,654	Ensure premium volume adaquately covers loss costs and other underwriting expenses. The benchmark loss ratio range is generally 45% to 95%, depending on volatility of the risk and need to build surplus capital.	Quantitative ▼ 5 ▼		The loss ratio is within the benchmark range. Premium covers losses and aligned services expenses and allows for continued increases to surplus capacity. The captive's performance exceeds established goals.	5 ▼	Consider lowering premiums (minimally), increasing the level of coverage, adding additional coverages, and/or increasing the spend on claims management. Ensure premium reflects insurance market conditions and that the captive is not overcharging premium.
Losses	1,050,986						
Current Yr Loss Ratio	57.3%						
All Yrs Loss Ratio	60.5%						
Materiality	36.4%						
**2) Reduce Total Costs of Risk**
**A) Retention Management**
*Insurance Risk Transfer*
**B) Other Non-Loss Costs**
*Taxes*
**C) Loss Costs**
*Loss Rate Trends*
*Claims Management Techniques to Control / Lower Claim Costs*
*Loss Prevention and Control Techniques to Lower Claim Costs*
**3) Build Surplus**
**A) Protect Business Assets / Stabilize Premiums_Losses**
**B) Diversify Into Profitable Business**
**4) Maximize Return on Invested Funds / Opportunity Cost / Risk Profile**
**5) Improve the Risk Management Function**

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Dashboard

* **Consolidates data in the Scorecard for strategic monitoring, analysis, and reporting**

* **Captures significant data but focuses on the most important information**
    - *Step back from Scoreboard details to see key trends and relationships*
    - *Monitor what is going on at a glance*

* **Offers the ability to easily perform "what if" analysis**

* **Visualizes and tracks trends on captive operations to align activities with key goals**

* **Identify when and where important adjustments should be made**

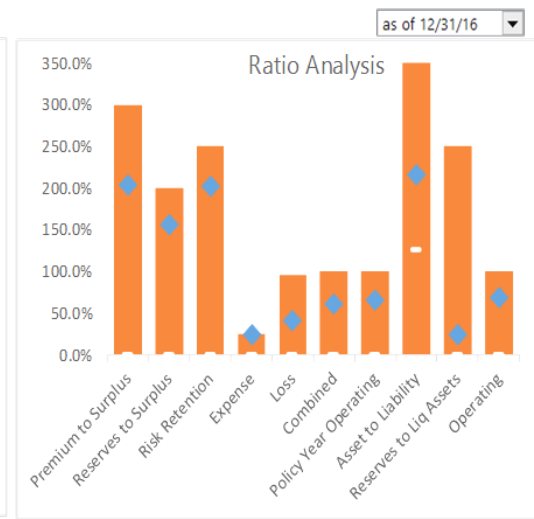* **Looks attractive and inviting**

* **Creates a "Report Card"**

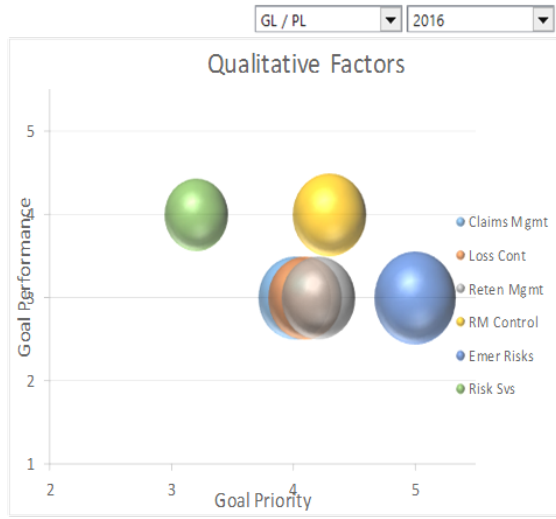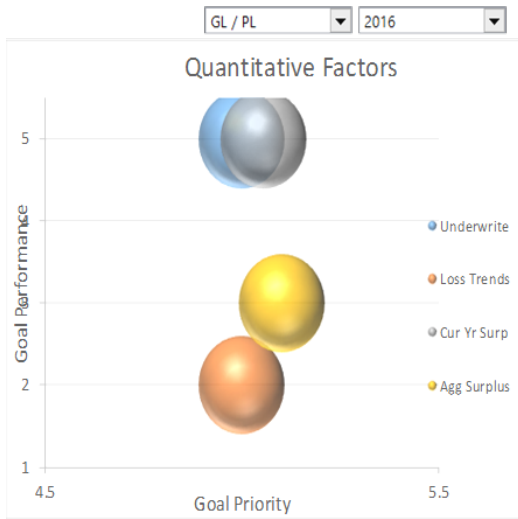PAC Conference

Dashboard Example

2016 Captive KPI Dashboard

2016 ▼

Coverage	Underwriting Metrics				Loss Rate			Surplus Contribution			Opportunity (Cost) / Benefit		Tax Benefit	Retention Mgmt
Type	Premium	Losses	Loss Ratio	Trend	% Inc / (Dec)	Trend		Cur Year	Inc / Dec Prev Yr	Aggregate	2% Borrow Cost	10% WACC		
WC	2,110,502	1,406,844	⏸ 67%		✖ 25.0%		✔	803,658 ✖	(205,629) ✔	4,501,604	76,875	(325,441)		
GL / PL	2,112,547	996,544 ✔	47%		✖ 27.0%		✔	1,161,003 ✖	(519,409) ✔	3,620,358	78,598	(124,886)		
Other														
Other														
Other														

GL / PL ▼ 2016 ▼   GL / PL ▼ 2016 ▼   as of 12/31/16 ▼

Quantitative Factors
- Underwrite
- Loss Trends
- Cur Yr Surp
- Agg Surplus

Goal Performance / Goal Priority

Qualitative Factors
- Claims Mgmt
- Loss Cont
- Reten Mgmt
- RM Control
- Emer Risks
- Risk Svs

Goal Performance / Goal Priority

Ratio Analysis
Premium to Surplus, Reserves to Surplus, Risk Retention, Expense, Loss, Combined, Policy Year Operating, Asset to Liability, Reserves to Liq Assets, Operating
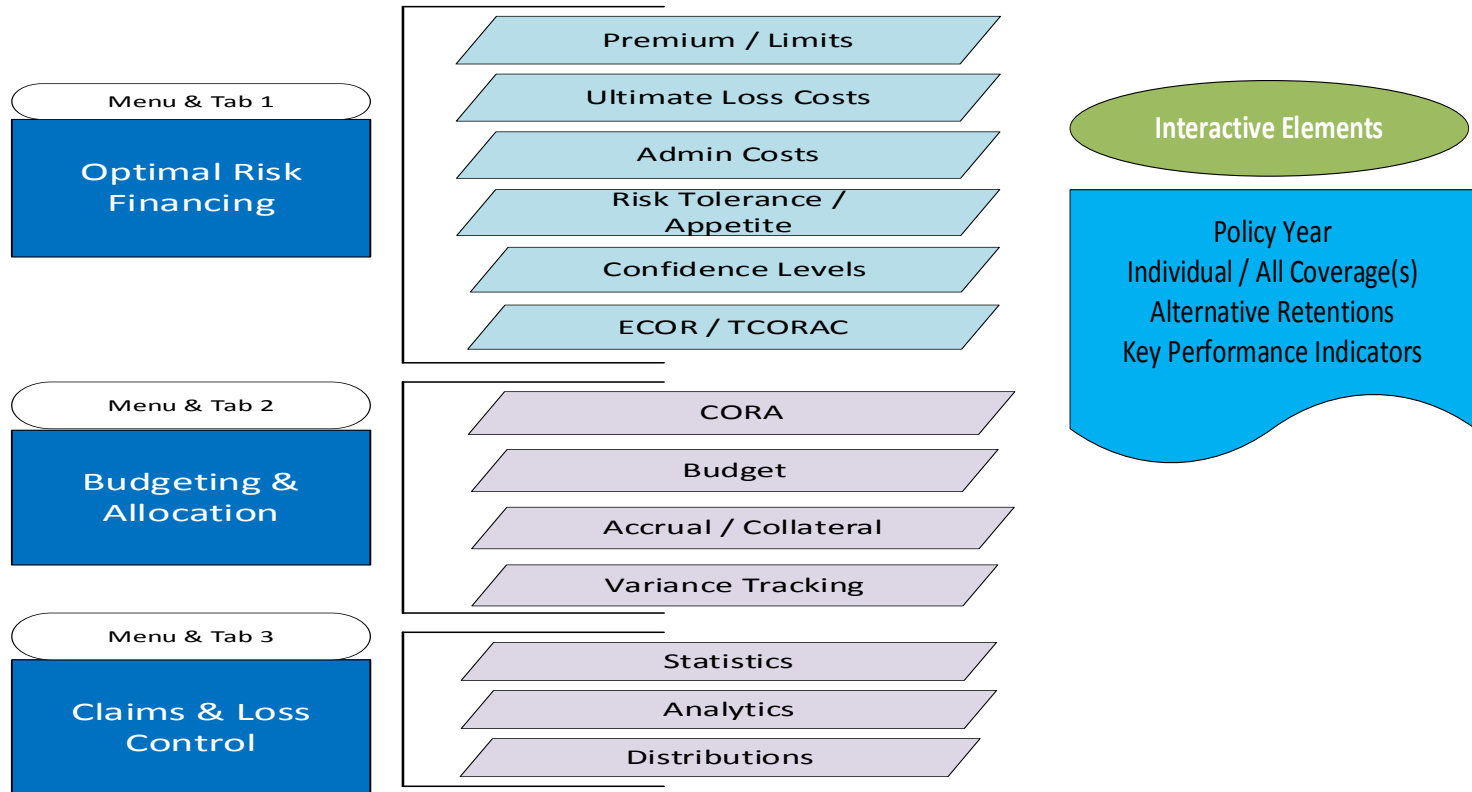
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What's Next?
Improving SCOUT - TCOR+

❊ **Enhancing SCOUT to address any risk financing program**

    ❊ **Adds interactive, connected system of dashboards for each component within a risk management program**

        1. **Optimal Risk Financing**

            – **Decision support framework to demonstrate optimal risk financing structure**

        2. **Budgeting and Allocation**

        3. **Claims and Loss Control Statistics / Analytics**

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Early TCOR+ Framework

Hanover Stone Partners LLC
Objective. Creative. Comprehensive.

Menu & Tab 1

Optimal Risk Financing

- Premium / Limits
- Ultimate Loss Costs
- Admin Costs
- Risk Tolerance / Appetite
- Confidence Levels
- ECOR / TCORAC

Menu & Tab 2

Budgeting & Allocation

- CORA
- Budget
- Accrual / Collateral
- Variance Tracking

Menu & Tab 3

Claims & Loss Control

- Statistics
- Analytics
- Distributions

Interactive Elements

Policy Year
Individual / All Coverage(s)
Alternative Retentions
Key Performance Indicators

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Risk Financing Decision Framework

- Risk Tolerance (i.e., risk you are prepared to take)

- Risk Appetite (i.e., risk you are comfortable taking)

- Optimize your risk taking (i.e., determine its value relative to above)

- Key Variables (at alternative risk retention levels)

- Key Considerations

- Key Decision Criteria

Key Variables

- Projected losses (retained and excess)
- Premium (insurance and/or reinsurance) quotes
- Operating expenses not included in premium

  (e.g., internal risk management, unbundled claims administration fees, broker fees, state assessments, premium taxes)

- Risk / Capital
- Taxes / deductibility
- Investment Income
- Time value of money

Milliman

Key Considerations

- How to measure risk?

- Most important decision criteria / metrics?

- Desired planning time horizon (short-term vs long-term)

- Funding / capital considerations

- Insurance market cycles
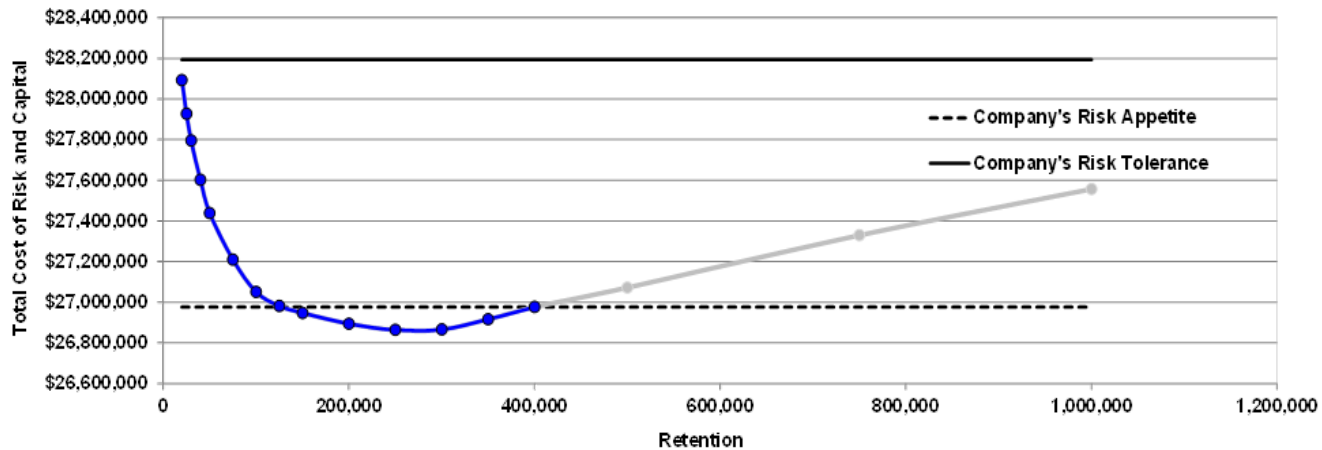
Key Decision Criteria

- Metrics
  - Total Cost of Risk ("TCOR") - minimize
    - Expected losses + excess/reinsurance costs + operating expenses
  - Total Cost of Risk and Capital ("TCORAC") – minimize
    - Expected losses + excess/reinsurance costs + operating expenses + cost of capital-at-risk
  - After-Tax Return on Equity ("ROE") – maximize
    - Net Income / Invested Capital
    - Applicable to captive only

TCORAC Decision Criteria

Company Desired Confidence Level (i.e., % of time losses will be less than desired amount) = 95.0% <=== INPUT REQUIRED

Optimal Retention (lowest TCORAC level at or below company's risk appetite) = 250,000

95% Confidence Level

- - - Company's Risk Appetite
—— Company's Risk Tolerance

(Y-axis: Total Cost of Risk and Capital — $26,600,000 to $28,400,000)
(X-axis: Retention — 0 to 1,200,000)

NOTE: This process and the resulting output are limited, and a more detailed actuarial analysis could result in different outcomes.

Decision Criteria	Guaranteed Cost	Self-Insurance	Captive
Minimize TCOR	Applicable	Applicable, yet Suboptimal	Applicable, yet Suboptimal
Minimize TCORAC	N/A	Optimal in comparing vs. captive, and in comparison against alternative retentions	Optimal in comparing vs. self-insurance, and in comparison against alternative retentions
Maximize After-tax Return on Equity	N/A	N/A	Optimal; compare to Corporate hurdle rate

Expansion / Application Possibilities

❄ **Integrated / Enterprise Risk Management ("ERM")**

❄ **Assets or inter-company investments (balance sheet)**

❄ **Regulatory compliance, per enhanced governance**

❄ **Ratings agency reviews**

❄ **Workers' Compensation claims predictive analytics**

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