NOTES FROM KING STREET

Quarterly Newsletter from Energy Insurance Services, Inc., Volume 2, Issue 1

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View from the Corner

At this point, I hope you are tying up the loose ends of 2017 and diving into the tactical execution of your 2018 goals. Having put year one of the EIS and ECM three-year strategic plan behind us, we have made a minor revision to our vision and plan going into 2018.

The primary drivers for this include:

- Federal Tax Cuts and Jobs Act
- ECM Risk Modeling

<u>Federal Tax Cuts and Jobs Act</u>

The new tax rate of 21% puts EIS in a great position to accelerate the expected timeline for the EIS General Account targeted surplus level of $3. 5 million (this target is derived from our ERM impact analysis). At the end of 2017 our surplus position was $2.9 million. Going into 2017 our plan was to reach the targeted surplus by year-end 2020. We now expect to reach this target by mid-2019 (provided all else remains equal). Along with reaching this plateau, EIS will be positioned to recalibrate our management fee structure and provide added services. The goal will be to continue to provide a stable platform at an ever-increasing cost efficient captive management partner with our EIM Members.

<u>ECM Risk Modeling</u>

ECM is now capable of providing a ‘first look’ financial analysis to help EIM Members evaluate the use of a captive structure for their risk financing needs. We hope this will help EIM Members get a better perspective of the possible value a captive facility can add to their risk financing options. A first look analysis should be considered as an indicator for a risk manager to make a go or no-go decision to proceed with a full captive feasibility or optimization study with an independent provider.

2018 EIS Program Advisory Committee Conference

EIS is pleased to announce the 2018 venue and dates for this year's Program Advisory Committee (PAC) Conference. The venue will be The Beach Club at The Charleston Harbor Resort and Marina from October 22 through October 25. As in the past, individual PAC meeting time slots will be set up for Monday, Tuesday and Thursday. We will have a Roundtable Session on Tuesday afternoon and a General Session on Wednesday morning. Here is the link to the venue's website: Charleston Harbor Resort Beach Club

We hope to see you in October.

Focus on Benefit Financing

Many companies are looking to de-risk their pension plans by replacing a portion of their massive pension funds into an annuity insurance policy. Those that are adopting this risk transfer strategy of funding employee pensions remove their balance sheet liabilities, investment risk and other concerns including those that come with a change in control of the sponsor organization. The insurance companies providing these annuities reportedly are somewhat dependent on reinsurance to help bear this risk. It seems that a global rush to de-risk pensions using this strategy is causing a capacity crunch for reinsurance support. Over $100 Billion of pension value was moved into risk transfer strategies in 2017 with 60% occurring in the USA. This year that trend appears to be continuing.

Some plan sponsors are using captive insurance structures to help support insuring their pension exposure with annuities. Investing in annuities through a captive has some advantages that has been compelling to a number of larger corporations. Please contact us if you would like to know more.

Captive Optima

Just as the EIS General Account surplus is expected to enjoy accelerated growth, captive participants with profitable underwriting performance and positive investment income will enjoy seeing their captive or MBP account surplus grow at an accelerated pace due to the Federal tax cuts. Over time, this will create more value held within the captive that can be deployed to:

1. add new lines of insurance
2. increase limits of existing covered lines
3. take surplus distributions back to insureds
4. a combination of the above

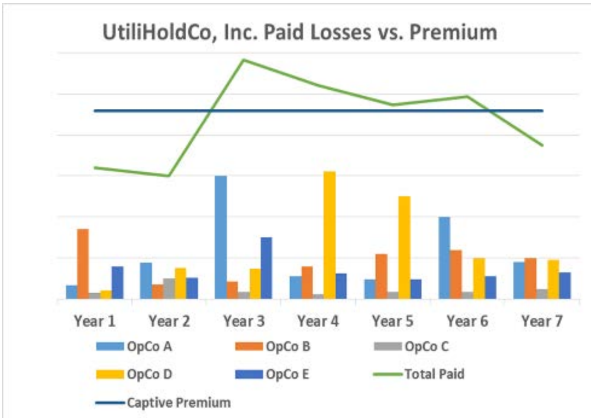
The new tax rate is an upside to a committed or mature captive participant. For prospective captive owners or participants, the tax cut will create more sensitivity to the payback period of recouping the initial feasibility study and startup capital. The payback period to achieve a breakeven point is largely measured by the expected cash flows of the options to finance risk. The cost of retaining risk by paying for losses as they arise under an S.I.R. or a high deductible plan, although debatable, is sometimes seen as a very cash flow effective strategy. However, there is something to be said for providing budget and expense certainty by taking retained risk into a captive insurer via a sustainable, predictable annual premium. By doing so, the uncertainty of loss payments, volatility of frequency and severity of loss and bringing control to claim determination negate cash flow arguments against the use of a captive.

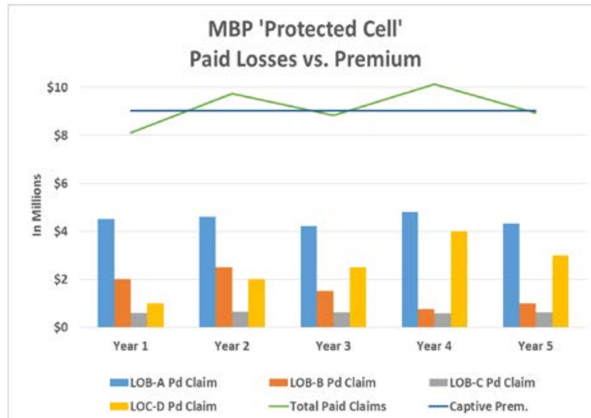
A very important aspect of risk financing option analysis is understanding the historic payout pattern of your losses. International Risk Management Institute publishes data on several lines of insurance in their Risk Finance section. This chart is a graphical representation of their most recent payout profiles for workers' compensation, general liability and auto liability.

From recognition to closure, claims over time show some predictable patterns that are somewhat reliable.   So, as you may recall, last quarter we looked at risk correlation and the possibilities of a portfolio effect on required capital and the increased certainty of expected losses. This portfolio effect also factors in on the overall cash flow advantages a captive. The portfolio effect can be obtained from a variety of different coverages or operating companies under a holding company or both.

Whether you are bringing risk from several operating companies or only one with a variety of risks (lines of insurance), you have the opportunity to deliver more certainty to the captive participant than taking exceedingly high retentions or deductibles or trading dollars with an insurer.

A captive participant can play its unique loss and loss payout pattern against broad based industry or commercial insurer losses. This enables the captive participant to collect an adequate overall premium (no more; no less) and meet the cash flow needs of the individual coverage or operating companies selected to be insured in the captive. This provides budget certainty to the company as a whole, by replacing paid claims with a stable premium. The following charts help represent the certainty captive premiums can bring to an organization, whether it is a single entity or a holding company with multiple operating companies.





The clustered columns represent paid losses by operating company (OpCo) or a line of business. The green line is the sum of claims paid per year. The blue line represents a reasonable annual premium to promote a sustainable captive program.

EIS Financials & Operations

Energy Insurance Services, Inc.
Key Financial Data - As of December 31, 2017

	2017	2016
EIS General Account		
Shareholder Equity	$2.9 million	$2.5 million
Mutual Business Programs - Aggregated		
Revenues	$61.5 million	$60.5 million
Gross Loss and Loss Expense	$86.1 million	$51.9 million
Assets	$1,456.5 million	$1,281.9 million
Liabilities	$1,314.7 million	$1,147.6 million
Surplus	$141.7 million	$134.4 million
Key Operational Data		
Active MBP Count	15	14
Policy Count – In Force	54	55
Gross Premium	$209.0 million	$169.2 million
EIM Member Participant Count	19	18

Helpful Links:

General Captive Information | **South Carolina Captive Information**

Disclaimer – This publication is for informational purposes only. It is not a solicitation of insurance or management services.

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