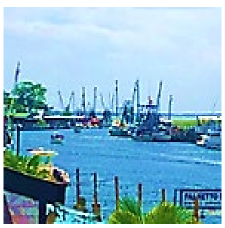
VIEW ON THE CREEK November 20, 2020

VIEW ON THE CREEK

Quarterly Newsletter from Energy Insurance Services, Inc., Volume 4, Issue 4

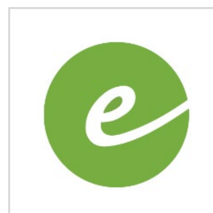
In this Issue:



View on the Creek

Captive Optima

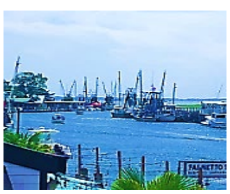
Focus on Benefits



Operational Considerations

EIS Financials & Operations

View on the Creek



This is our fourth and last newsletter of 2020. We are looking forward to next year, and for us it cannot arrive too soon. However, this is not the time to let your guard down. Risk financing challenges continue now and into the foreseeable future to negatively impact our Participants' insurance program budgets and the insurance capacity in both property and liability lines. Many discussions have occurred this year with EIM Members looking for alternative solutions, while our Participants are increasing utilization of their EIS programs to meet these challenges.

Our headliners for this quarter are

- **Program Advisory Committee Meetings**
- **New MBP Launched**

<u>Program Advisory Committee (PAC) Meetings</u>

We are very pleased to have met with the Mutual Business Programs (MBPs) last month to review their financial performance, underwriting programs, claims, upcoming renewals, new coverages, plans and operational issues of interest. In effect, this is a highly collaborative communication between our PACs and EIS to execute the Participant's risk financing strategy within their Mutual Business Program. The level of engagement from our PAC members has been great, and we look forward to next year when we will hopefully be back to in-person meetings.

For those readers new to EIS and the contractual structure with our Participants, I hope the following will add context to what a PAC is and the significance it brings to our operational effectiveness. The PACs consist of designated representatives, typically within the risk and insurance department, from each EIS Participant's organization. The PAC advises EIS about how the Participant wants its risk financing strategy to be ultimately executed within the MPB. Specific responsibilities are outlined in the EIS Participation Agreement for each MBP. EIS acts upon informed and appropriate recommendations to execute a multitude of transactions. Recommendations include nearly all transactional activity within an MBP, such as wording of policy coverage terms, paying claims, securing reinsurance, and creating an investment policy to mention a few common activities. EIS reviews each recommendation to assure its prudency from an insurance company perspective within the bounds of the South Carolina Insurance Code and regulatory standards.

New MBP Launched

We are very happy to announce the launch of a new Mutual Business Program by Pinnacle West Capital Corporation. This is EIS' fourth new program in the past five years. The methodical evaluation by Pinnacle West is a testament to the care it gave to measuring expected outcomes to meet risk financing objectives. Like many Participants before them, Pinnacle West will start slow and look to grow into additional coverages in due time.

Given the level of interest expressed across a wide range of EIM Members and their depth of exploration, we expect the pace of formations will pick up over next year.

Captive Optima

Are you beginning to explore a captive? Most risk departments do not launch into a feasibility study as a starting point. However, many risk managers are engaging in risk financing optimization (RFO) studies particularly in the utility sector. Many EIM Members have taken advantage of their NEIL Membership to have an RFO study performed. Although this type of study does not usually consider the use of a captive, it can be useful to help frame the foundation to begin an exploration of a captive strategy.

An RFO looks at your losses, insured limits, the structure of the limits along with paid premiums per layer of coverage. The study then models these elements to arrive at suggested optimal retentions, optimal limits and structure with a suggested optimal rate or cost against the current layers of insurance and to help baseline against your actual cost of risk.

Approaching the findings of a risk optimization study in the context of how a captive may fit into your overall strategy can be enlightening.

Start with a SWOT Analysis!

However, before, or along with, an optimization study and/or a captive feasibility study, we have a suggestion: Start with a SWOT (or situational) analysis! This is a method of evaluating the strategic attributes of your specific internal and external environments by assessing your department's strengths and weaknesses and your external opportunities and threats.

This can lead to the creation of a vision of how a captive may fit your overall strategy, or not. The internal aspects are addressed with the strengths and weaknesses and the external aspects are covered by opportunities and threats. Let us look at a quick sampling of some aspects you may find in each element of a SWOT:

- ***Strengths*** from the perspective of your department and/or company will be attributes that may bring advantages and positive contributions to the utilization of a captive insurer. A strength may include staffing adequacy and expertise to help manage or provide oversight to a captive facility. Your organization's corporate structure may be prime for achieving tax advantages due to the ability to show risk sharing among several operating companies. Another strength may be having years of credible loss data that will provide an excellent basis for loss forecasting and modeling.
- ***Weaknesses*** are internal attributes that will present difficulty in seeking risk financing alternatives in a captive insurer. One weakness may be an inability to provide a long-term commitment to a captive strategy. Others may be the antithesis of some of the examples discussed above under strengths.
- ***Opportunities*** are those external attributes that will contribute to a successful engagement of a captive strategy. These may include having strong external relationships with your broker (or mutual insurer) that will be capable to support a captive strategy.
- ***Threats*** are external issues or conditions that may bring an undesired outcome from a pursued captive strategy. Threats may include changes in regulatory or statutory environments in a targeted captive jurisdiction. A major shift by the IRS against captive insurers is an item always on EIS' threat chart, albeit a very unlikely threat.

Going through this analysis of pros and cons will help set or re-set the foundations of a captive strategy to meet the unique needs and objectives of your risk group and overall company. We hope that by thinking about these attributes it will help you focus on your objectives and expected outcomes for a successful and sustainable risk financing strategy.

Focus on Benefits – Using a Captive to Reinsure Voluntary Benefits

Voluntary benefits are 100% employee paid and designed to provide financial protection and security from a variety of circumstances that employees face and will otherwise incur on their own. Voluntary benefits offer programs to provide these financial protections at a minimal cost, and many employers find them to be advantagous to remain competitive in the labor market.

Most captive owners and Participants when considering to reinsure voluntary benefits largely focus only on life and disability coverage. However, there are many other voluntary benefits that can be reinsured by a captive insurer (or "in a captive facility"). These include

- Critical illness
- Large medical deductible buy backs
- Co-insurance
- Pet insurance
- Hospital indemnity
- Accident expense
- Legal expense

Typically, voluntary benefits have the following characteristics:

- Highly predictable
- Low to no chance for catastrophic loss
- Short tail loss horizon

Given the characteristics of voluntary benefits, substantial advantages can be gained financially and in an overall employee satisfactory experience:

Employees can have an enhanced benefits selection, increased coverage or reduced premiums, all leading to improved financial security.

Human resources will have more control over voluntary benefit plan design and pricing and can provide a more competitve benefits package to attract and retain employees.

Captive risk management will be enhanced with added diversification with low risk, highly predictable exposure, effective use of existing capital, and third-party premium.

However, most owners or participants do not pursue a reinsurance option within their captive insurer facility because of the exemption process with the Department of Labor (DOL) and the EXPRO (class exemption PTE 96-62) approval process. It is largely considered a difficult and arduous process. Currenlty, the DOL has been rather slow to consider and return an answer to employers. EIS is seeking an opinion from the DOL to provide assurance that insuring benefits within an EIS protected cell are not subject to this exemption process. Although we have some positive indications at this point, we, like others, are waiting for an official opinion. Either way, the analysis of the gains will likely overshadow the costs to bring benefits into a captive.

Operational Considerations – A few housekeeping items

Power of Attorney for EIS updated

Please note with the recent change in our Controller position we have updated our Power of Attorney (POA) document. Megan Ogden replaces Jeff Tkacz, and we changed our address to our new Mount Pleasant location. Tobias will be sending the new Power of Attorney as renewal letters are transmitted to our Program Advisory Committees or primary point of contact for each Mutual Business Program. Please be watching for these emails. We look to have a newly executed POA for each MBP after the next renewal cycle.

EIS Financials

Energy Insurance Services, Inc.
General Account – Key Financial Data

(in thousands)	As of September 30			Full Year		
	2020 Actual	2020 Budget	2019 Actual	2020 Forecast	2020 Budget	2019 Actual
Revenue	$1,500	$1,458	$1,932	$1,947	$1,944	$2,530
Expenses	$1,260	$1,277	$1,173	$1,720	$1,824	$1,691
Surplus	$4,349	$4,328	$4,106	$4,379	$4,260	$4,166

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EIS Mission Statement – "To provide a facility to meet EIM Members' dynamic and specific business requirements for the placement and management of alternative risk solutions."

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