VIEW ON THE CREEK

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Quarterly Newsletter from Energy Insurance Services, Inc., Volume 7, Issue 3

In this Issue:

View on the Creek

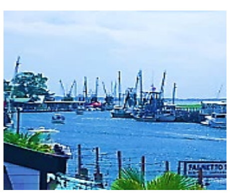
Captive Optima

Operational Considerations

EIS Financials & Operations

Save the Date

View on the Creek – *2023 Midterm Report*



WOW! EIS had a big summer and we continue to field new inquiries from EIM Members looking to explore the alternative advantages offered by a captive insurance facility for retaining or reinsuring risk in various lines of business. Individual members and groups of members are seeking means to create capacity at an affordable cost while also addressing insurance program changes and challenges. The top risk issues in these member discussions include:

- Wildfire
- Conventional Property
- Renewable Generation Property
- Excess Liability

Two New MBPs Welcomed by EIS

Please join us and welcome Berkshire Hathaway Energy and Ameren as the latest EIS Participants. We are very pleased Berkshire Hathaway Energy found EIS as a viable alternative to address wildfire risk. EIS worked closely with Ameren and their broker to provide coverage in a middle layer of their excess liability program. Our current number of open cells is now at 21.

Anniversary Announcement

Please join us in congratulating Tameeka Heyward on her 2nd anniversary with Energy Captive Management. Tameeka has been a wonderful addition to the ECM / EIS team.

Captive Optima – *Captive Success Story*

Everyone loves a good success story! While we have several success stories to share at EIS, we've chosen to highlight a cell inherited by a risk management team through an acquisition of a large utility company in early 2019. Prior to the acquisition, the cell was only writing two policies, both fully ceded into the market. In 2021, the risk management team began utilizing the acquired cell to help their organization save money and solve coverage issues. Through Q2 2023, the cell has grown its surplus by $7.1M and investment portfolio by $8.9M.

The risk management team has incurred various issues in the insurance program over the years and their EIS cell has been able to quickly and effectively help resolve some of these issues for the organization. Here's a list of the current policies written in the cell:

- Excess liability - quota share 20% of $50M excess $5M*
- Property - quota share 10% of $100M excess $10M*
- Nuclear property - quota share 10% of $400M excess $10M*
- Solar all-risk property - $4.8M excess $200k*
- Solar builders' risk projects - $4.75M excess $250k

    * These coverages are subject to a $10M umbrella aggregate limit

The cell also purchases an Aggregate Loss Reinsurance Policy with a $10M limit to protect the assets and surplus of the cell. This cell is a great example of diversifying an insurance program to maximize the availability and growth of surplus over time.

This cell has also benefited from the use of our in-house actuary to determine funding, capitalization, and IBNR requirements for the various lines introduced into the cell. Market quotes, loss history, and exposure data were used to provide funding projections and capital estimates in a very timely fashion due to our actuary's expertise in the captive and energy industries. The actuary report has been a critical component when determining limits, attachments points, and annual premium to be written in the cell.

The risk management team also consulted with their corporate treasury department to implement an investment strategy with the goal to maximize investment returns while still preserving the capital necessary to cover reserves and claims. The current portfolio consists of 2% cash, 57% short-duration US treasuries, and 41% mutual funds. The asset allocation and treasury duration are reviewed on a quarterly basis to determine if the portfolio is still meeting expectations and to allow for any adjustments based on cash flow projections. This portfolio has been successful with 7% returns since the acquisition. Typically, captive insurance companies have a fairly conservative investment policy.

The increase in surplus and growth of the cell is primarily attributable to the favorable loss experience of the insurance lines written. These risks were strategically selected with the expectation there would not be significant loss activity in the first five years of coverage. This strategy has provided the organization with the flexibility and opportunity to increase risk retention and diversify into other areas since there is sufficient capital to pay claims when they occur.

Energy insurance experts predict markets will continue to present challenges in the areas of pricing, capacity and coverage terms. Whether an organization already has a cell in EIS or is exploring a new cell, now is a great time to review the insurance strategy and explore alternative risk financing options. An EIS cell can be a very valuable tool to reduce costs, customize coverage, and increase capacity in multiple lines of an organization's insurance program.

Operational Considerations – *Financial Ratios*

When looking at your financials at period end, it is important to view the numbers and what their balances look like over previous periods, but is that all you should be looking for? Most financial reports will present ratios to help assist your understanding of your captive's financial performance, but do you understand what these ratios mean and what the importance of them are? Financial ratios will take the numbers that you see on your financials and help provide further clarity on the financial position of the captive. Here are several key ratios that you likely have seen:

- **Reserves to Surplus Ratio** is the ratio of all reserves set aside for unpaid losses to surplus. This indicates how much risk each dollar of surplus supports. It is usually expressed as a percentage.
- **Net Premium Written to Surplus Ratio** is the ratio of gross premiums written less reinsurance ceded to surplus. This is used to measure the level of net losses the insurer can absorb after reserves have been depleted (not considering investment or other income to the cell). Further it sheds light on the capacity of a captive to underwrite new policies.
- **Loss Ratio** is the ratio of losses incurred to premiums earned. A high loss ratio could be an indicator of financial distress, but it does not always mean there is a problem. It is very important to consider the claims that have been incurred during the period and understand the nature and recurrence of these claims along with the coverage lines in the captive and the associated premiums. This ratio is often analyzed in conjunction with the Combined Ratio to get a bigger picture of profitability.
- **Combined Ratio** is the ratio of incurred losses and expenses to premiums earned. It measures the money flowing out of the captive in relation to the premiums earned and provides a comprehensive measure of a captive's profitability. It is typically expressed as a percentage. A ratio under 100% indicates that the captive is making an underwriting profit, while a ratio above 100% indicates that the captive is paying out more money in claims and expenses than it is receiving from premiums. This ratio does not consider investment income, so even if the ratio is above 100%, a captive could still be profitable if it has investable assets.
- **Liquidity Ratio** is the ratio of cash and marketable securities to loss reserves. There are several versions of liquidity ratios including current ratio, quick ratio, and operating cash ratio, but the above calculation is what EIS uses for its cell captives. This ratio measures the captive's ability to pay off current debt obligations (loss reserves) without raising additional capital. This ratio provides insight into a captive's ability to convert assets into cash quickly. In general, a higher liquidity ratio shows that a captive is more liquid with a more conservative coverage of outstanding losses.
- **Return on Equity Ratio** is the ratio of net income to surplus. It is often presented as a percentage and is used as a tool to measure how effectively a captive's assets can create profits. A relatively low or high return on equity ratio will vary significantly from one captive to another and should align with the captive's role in the overall risk portfolio.

Each captive has a different strategy for risk solutions, so it is wise to consider your captive's own goals when reviewing the picture that the financial ratios paint. Obviously, if you have no losses or investments, then the loss ratio of return on equity ratio will not add much value to your decision making. A captive that retains risk will likely show more value in the reserves to surplus or combined ratio than a captive that passes through to access reinsurance markets. Whatever the strategy of your captive, keep in mind that financial ratios can be a key component to assist in directing the captive's future.

EIS Financials

General Account	As of June 30		Year-End		
	2023		2022		2021
In thousands	Actual	Budget	Actual	Budget	Actual
Revenue	**$1,107**	**$1,087**	**$2,049**	**$1,954**	**$2,002**
Expenses	**$816**	**$887**	**$1,929**	**$1,819**	**$1,856**
Surplus	**$4,817**	**$4,739**	**$4,586**	**$4,609**	**$4,503**

Save the Date

<u>PAC Conference Registration is Open</u>

Our conference is commencing Monday, October 23 in Charleston. The General Sesssion will be held on Tuesday morning with an EIS update, South Carolina Department of Insurance presentation and Investment Panel. Individual PAC meetings will be held throughout the week and there will be networking opportunities during the conference. We look forward to seeing most of you in Charleston. If you have any other questions, please do not hesitate to reach out to Megan Ogden or Taniyka Ragland.