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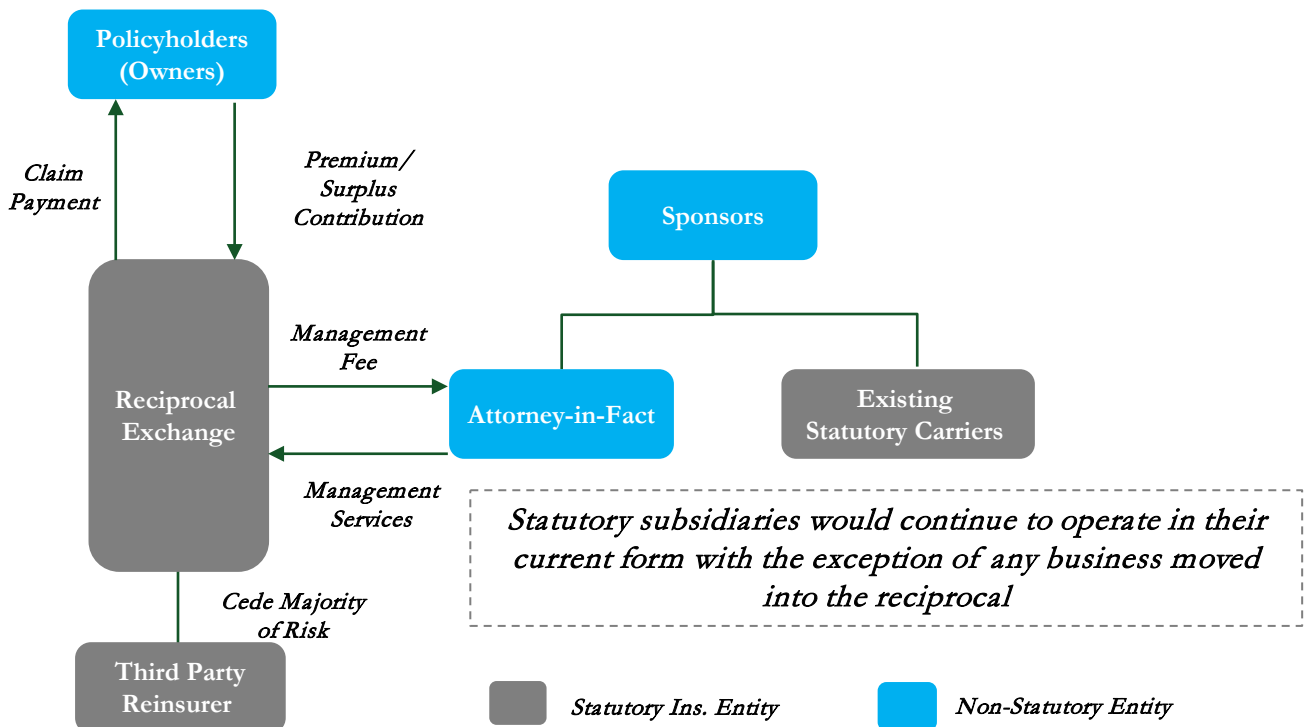
## Reciprocals and Captives

There has been increased interest in forming reciprocal and captive insurers to better align the distribution and taking of risk. This paper reviews these types of platforms and other independently funded and controlled insurers.

### Reciprocals – Structure and Benefits

- **Reciprocal exchanges have become an increasingly popular structure, most notably in the Florida market**
  - Similar to a mutual insurance company, the policyholders own the entity
  - The reciprocal is managed by an attorney-in-fact – which is often owned by the sponsors
- **The key advantage that the reciprocal/attorney-in-fact model has over the carrier/MGA model is that the Attorney-in-fact (“AIF”) is not exposed to any balance sheet risk**
- **Reciprocal’s AIF’s are currently seeing higher valuations than carrier’s MGAs**
- **Reciprocals are a self funding entity - the capital and surplus of a reciprocal exchange is generally contributed by the policyholders**
  - Member surplus contributions allow for growth of organic surplus, with potential tax advantages
  - Surplus notes can be another source of capital
- **A Reciprocal can be formed by moving an existing book of business through renewal rights into the reciprocal exchange**

### Reciprocal Structure – Illustrative Example



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## Recently Formed Reciprocals – Key Players

Company	Commentary	Ownership/Financing
	<p>TRUE offers owner-occupied homeowners insurance and flood solutions for medium to high-value homes. Products were initially distributed in Florida, with plans to expand into other Gulf States. Received an “A-” FSR rating from AM Best.</p>	
	<p>Pure was founded in 2006 to service the growing US High Net Worth market. In 2019 Tokio Marine Holdings acquired Pure Group for \$3.1B. Prior to the acquisition, Pure had organically grown by more than 20% each year, to over \$1B of premiums in force.</p>	
	<p>Kin was incorporated on 6/30/16. On July 19, 2021, Kin entered into an agreement with OmniChannel Acquisition Corp. This agreement implied a \$1.03b pro forma enterprise value. It has subsequently been withdrawn and Omnichannel will liquidate.</p>	
	<p>On 9/7/21 Tower Hill Insurance Group announced the formation of Tower Hill Insurance Exchange (THIE). THIE will be formed as a reciprocal, with Tower Hill Risk Management acting as the attorney-in-fact. THIE was capitalized with \$200m. Tower Hill companies are rated “B+” (Outlook Negative) by AM Best.</p>	
	<p>On February 2, 2021, K2 Insurance Services, LLC, an insurance services holding company, and New York based private equity firm Lee Equity Partners, announced the formation of American Mobile Insurance Exchange (“AMIE”). AMIE will focus on writing mobile homeowners and mobile homeowner dwelling fire largely in Adult Parks, across the State of Florida.</p>	
	<p>On May 12, 2021, Property Cat-focused MGU and insurtech SageSure partnered with newly established SureChoice Underwriters Reciprocal Exchange (SURE) to bring new homeowners capacity to Texas. The Demotech, A-rated reciprocal exchange start-up is the first to be launched in Texas since 2004.</p>	

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## Captive Market Overview

Captive insurance are becoming more attractive for a number of companies in the current hardening market. Companies are struggling to insure their unique risks and are faced with high premium rates and tighter terms and conditions. This has led to captive insurance being a popular alternative to traditional reinsurance coverage. Over the past 21 years, the operating performance of both US captives and Bermuda, the Cayman Islands, and Barbados (BCIB) captives rated by AM Best has exceeded that of their commercial peers. AM Best rates 200 captives worldwide, 25 of which are in the BCIB islands. The lack of public data makes it impossible to determine the experience of the larger group of the 5,895 captives reported worldwide in 2021 – however, the AM Best rated captives should be seen as a strong indicator.








### Vermont:

2021 was the 4<sup>th</sup> highest year on record for new captive licenses in Vermont, the largest domicile for captives in the US and the third largest in the world (1,242 captives YE 2021)

- 45 new captives
- 9 were sponsored cell companies
- 17 different industries – manufacturing, transportation, healthcare and real estate

Other popular US Captive domiciles include Utah, Delaware, North Carolina, South Carolina, Hawaii, Nevada, and Tennessee.

## Benefits of Forming a Captive

-  Ability to earn underwriting profit and investment income. Also, can increase net cash flows through tax-deductible loss reserves
-  Supports building up reserves which increases risk-bearing capacity
-  Control over all aspects of the insurance program – claims, reinsurance, investment managers, consultants etc.
-  Access to reinsurance markets which can offer broader coverage and more sophisticated pricing
-  Insures niche risks that could be difficult to place, or too volatile to maintain, in the traditional insurance markets
-  Promotes group level thinking about overall risk management strategies and solutions
-  Bespoke polices, contracts, terms and conditions

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## Types of Captives

### Ownership – Pure Captives

- I. **Single Parent Captive:** an insurance subsidiary that provides insurance to cover the loss exposures of its parent company. The parent provides risk capital and pays premiums for itself and its affiliates, and receives the cover the captive provides. Captive pays claims to the parent company.
- II. **Group Captive:** Owned by a number of different parent companies who are normally from the same industry.
- III. **Agency Captive:** Agency captives are owned by insurance agents in order to align interests of producing profitable business with their insurance companies and to create a new revenue source beyond commissions for the agency.
- IV. **Risk Retention Group:** Form of group captive formed under the Federal Liability Risk Retention Act of 1996. This law allows a group of people to form a risk retention group providing that they are all owners, from the same industry and only insuring commercial liability exposures. Risk retention groups are licensed as insurers by individual states and consequently avoid the need to obtain a front company to put in front of a captive.

### No Ownership –Sponsored Captives

- I. **Protected Cell Captives:** a legal, corporate entity in which the assets and liabilities are segregated and protected within one or many “cells” within the company, also called the “core.” Each cell is legally independent from the other cells and often from the main core itself. Therefore, each protected cell’s finances must be separately accounted for on the books of the core company. With this structure, the assets of one cell cannot be affected by the liabilities of another
  - 18% of new captives formed over the past two years were protected cells, compared with just 8% three years ago
  - Preferred structure for middle market medium sized corporations because of the quick formation process and less expensive operating cost
  - Can also be known as “Rent-A-Captive”
- II. **Fronting Partner Structure:** Insurance is provided by a fronting company, which reinsures the risks with the captive. The captive can reinsure part of its risk through retrocessions to the broader reinsurance markets

Type	Classes of Business	Need for Front?	Typical Domicile	Considerations
Reciprocals	Any, often coastal property	No	Onshore	Sponsor may have duty of care
Single Parent captives	Casualty, incl WC	Yes	Often offshore	Consolidates with parent
Group Captives and RRGs	Group captives, WC and Liab; RRGs Liab only	Not for RRG's	RRGs onshore	Members may have different goals
Agency Captives	Any	Yes	Often offshore	Need meaningful scale
Protected Cells	Any	Yes	Usually offshore	Some loss of control
Self insurance	Often WC and Malpractice	No	Onshore	Not tax deductible

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## How Stonybrook Can Help

### Captive Feasibility Studies

- Required by most domiciles. Stonybrook can perform the analysis or help coordinate an outside consultant

### Review of Strategic Alternatives

- Compare the cost and benefits of potential new structures

### Surplus Notes for New or Existing Carriers

- Stonybrook is THE market leader in raising capital in this sector

### Holdco Capital

- Stonybrook has completed five capital raises over the last two years

### Carrier to MGA or Reciprocal Conversion

- Many carriers would benefit from converting to a reciprocal format or finding 3<sup>rd</sup> party capacity for a piece of their book
- MGAs of reciprocal and hybrid structures reduce underwriting risk while benefiting from material valuation arbitrage

### Market Finding

- Stonybrook Risk Management has deep industry relationships with carriers specializing in a range of sectors
- Particular focus on homeowners, personal auto, general liability and worker's compensation

## Stonybrook Services | Global presence – HQ in NYC and offices in London & Bermuda

### Stonybrook's Advisory Services | Investment Banking

- **Middle market insurance specialist with a focus on:**
  - M&A, raising capital, mutual insurers, coastal state carriers, MGAs, divesting non-core assets, and valuation analyses

### Stonybrook Risk Management | Reinsurance Broking

- **Services provided include:**
  - Prospective carrier/MGA identification, product development, alternative risk, captive services, strategic advisory, and reinsurance placement
  - Fronting expertise

### Stonybrook Alternative Investments

- **Placement agent for a variety of insurance related funds:**
  - Insurtech Funds, Lloyd's Capacity, and Surplus Notes Fund

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## Notable Stonybrook Capital Transactions

May 2022	April 2022	March 2022	November 2021
 <p>Series A Financing</p>	 <p>Acquired by  AF Group</p> <p>Exclusive Buy-Side Financial Advisor</p>	 <p>\$7,500,000 Capital Raise</p>	 <p>Loss Portfolio Transfer</p>  <p>MAIDEN HOLDINGS, LTD</p>
September 2021	June 2021	May 2021	December 2020
 <p>Acquired by  Porch Group</p> <p>Exclusive Advisor to CSE's Management</p>	 <p>\$20,000,000 Capital Raise</p>	 <p>European Operations</p> <p>Acquired by  RESOLUTION UNDERWRITING</p> <p>Exclusive Buy-Side Financial Advisor</p>	 <p>Acquired by  MILESTONE PARTNERS</p> <p>Exclusive Sell-Side Financial Advisor</p>
December 2020	November 2020	October 2020	May 2020
 <p>Acquired by  Ambac</p> <p>Exclusive Sell-Side Financial Advisor</p>	 <p>Program Agreement</p> 	 <p>Acquired by  NORTHEAST COVERAGES</p> <p>Exclusive Buy-Side Financial Advisor</p>	 <p>Acquired by  Weston INSURANCE</p> <p>Exclusive Sell-Side Financial Advisor</p>

## Recent Stonybrook Risk Management Placements

<p>Market Finding Assignment</p> <p>Multi-State Surety</p>	<p>US and EU Retro Protection</p> <p>\$25M Excess of Loss Limit</p>	<p>Start-Up Coastal Homeowner Carrier</p> <p>Gross Account Quota Share</p>	<p>Northeast Regional Carrier</p> <p>Multiple Line, Catastrophe and Clash Excess of Loss</p>	<p>Dental and Medical Malpractice Insurer</p> <p>Excess of Loss</p>
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