NOTES FROM KING STREET

Quarterly Newsletter from Energy Insurance Services, Inc., Volume 3, Issue 4

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In this Issue:

View from the Corner

Captive Optima

Operational Considerations

EIS Financials & Operations

View from the Corner

2019 PAC Conference

We are very pleased with the outcome of the recent PAC Conference held at The Sanctuary on Kiawah Island, SC. Feedback has been very positive regarding this venue, along with the PAC meetings, the general session and the activities.

Highlights from the general session included Pete Nadel's excellent profile of the new umbrella policy he conceived and launched within the FirstEnergy program. Additionally, the presentation titled Data and Analytics: Today and in the Future provided by Ventiv Technology's Bill Diaz (CEO) and Kristi McFarlin (Chief Analytics Officer) was quite compelling as they walked us through the impact analytics via data aggregation is having and will have on risk management and strategic business decisions.

After most of the PAC meetings and the general session, many of our attendees and guests enjoyed a variety of activities Wednesday afternoon. The weather was exceptional as the golfers enjoyed the challenge of Turtle Point, the fishing excursion was a big hit (rather a big strike – fish on) and the island wandering tour enjoyed visiting a local craft brewery and a unique distillery.

EIS Fee Update Announcement

The management of EIS has announced a reduction in 2020 management fees. This is in response to member feedback and is consistent with EIS/ECM's drive for efficiency in management operations.

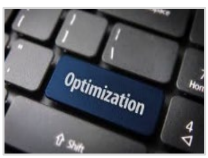
The reduction is more than 10% of 2019 member fees and will be applied on a pro-rata basis as a **one-time credit** against 2020 annual cell management fees for all **active** cells. The allocation is based upon cumulative fees paid by members up through 2019. This fee credit for 2020 is consistent with the long-term goal of EIS to provide cost-effective alternative market solutions to EIM members. This reduction for 2020 is also consistent with the need to provide members with a stable, financially solid core cell.

The Charleston team will contact each individual Program Advisory Committee with additional, specific details on the fee credit. Going forward, EIS will do an annual evaluation of member fees but **does not expect to make changes to base management fees**. Fee credits if warranted will be made on a year to year basis to the base management fee and will be dependent on EIS operations and financial condition.

Year in Review

EIS and ECM is staying on course. With a new cell formation and overall written premiums continuing to rise, EIS has had another solid year as an alternative solution to risk financing. Not to minimize this growth, we feel the most prevalent aspect of this year comes from the increase in authorized coverages. Four new lines of business were added to our list. Two covers, crime risk and fiduciary liability, came via the new umbrella policy, as mentioned above. Additionally, EIS issued its first drone (unmanned aircraft) physical damage policy and directors' and officers' policy. It is a privilege for us to work with the risk and insurance managers in the utility and energy sector as they initiate new coverages and structures to finance risk, effectively and efficiently, to meet their companies' needs.

Captive Optima



Terrorism Coverage

TRIPRA, as reauthorized in January 2015, is set to expire December 31, 2020. In an apparent effort to avoid a lapse in the Federal reinsurance backstop to protect insurers from a catastrophic terrorism event the current reauthorization act is, hopefully, well on its way to an early approval in Congress. The US House of Representatives has already passed legislation, H.R. 4634, the Terrorism Risk Insurance Program Reauthorization Act of 2019, as amended, to reauthorize the original TRIA of 2002. Additionally, the US Senate Banking Committee has passed S. 2877 and is moving their bill to the full Senate for reauthorization. As these legislative bills are currently written, the backstop will be extended for seven years to 2027. Industry trade groups are urging Senate leadership to move on a vote before year end. It is quite likely this will not happen in 2019, although these early actions of Congress are encouraging.

However, please note that the London Market Association has recently issued a letter to its members warning of the uncertainty of the TRIA reauthorization and is providing endorsement language for its members to attach to policies being issued next year that will address coverage limitations if reauthorization is delayed or abandoned. As EIS looks forward to our policy renewals in 2020, EIS may consider similar endorsements to address the potential of delayed or abandoned reauthorization for coverage periods extending past December 31, 2020.

As you may know, Department of the Treasury administers the program and EIS, by definition, is subject to the Act. Terrorism cover is offered to all EIS policyholders on the coverages subject to the Federal program requiring our terrorism election endorsement, T1 to be attached to all qualifying policies and T2 if the election is accepted.

Additionally, several Mutual Business Programs (MBPs) within EIS have insured terrorism risk for both property and liability coverage on two distinct stand-alone type policies. Both structures use reinsurance as a key element supporting their underwriting of this risk. One structure is a 'wrap' program and the other is a more traditional stand-alone policy. The wrap program was conceived and launched in 2010 by an EIS Participant. Several MBPs have utilized this structure over the years and it continues to the meet the needs of a few Participants while others have used their MBPs to issue policies using a traditional stand-alone terrorism structure. Both structures have been used to respond to terror risk to property and general/excess liability.

The traditional stand-alone terrorism policy is very straight forward. These are direct pass-through reinsurance transactions behind the EIS policy. The coverage limits match the EIS policy and responds to certified or uncertified terrorist events. The Participants using this method have found a convenience of administration and cost savings, as the reinsurance is less than the terrorism premiums charged to their standard policies.

The wrap policy is somewhat unique. EIS issues limits to match the desired level of risk insured on the Participant's liability/excess tower and/or the loss limit on their conventional property programs. The reinsurance behind the wrap does not match the EIS policy limit. The reinsurance limit is based on the expected insurer deductible and co-pay values of a full loss against the EIS limits. The balance of coverage to support the EIS policy limit comes from the US Treasury via an advanced payment for the 'Federal share of compensation'. The Federal share of compensation in 2020 will be 80% of any certified terrorism loss excess of the determined insurer deductible. The insurer deductible will be 20% of any direct earned premium for insurance covered by the Act. In EIS' case, this is determined by direct earned premiums from both EIS and EIM. EIS has a term sheet posted as a link on our website. Click here. Currently it addresses the Act's scope of risk for 2019. The term sheet will be updated for 2020 soon.

Operational Considerations – Financial Ratios: What do they mean & why are they important

ENERGY CAPTIVE MANAGEMENT

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 or return on equity 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 - Key Financial Data
As of September 30, 2019

	First 3 Quarters		2019 YE		2018
(In thousands)	2019	2018	Forecast	Budget	Actual
Revenue	$1,932	$1,836	$2,543	$2,431	$2,447
Expenses	$1,173	$1,266	$1,657	$1,630	$1,742
Surplus	$4,106	$3,373	$4,200	$4,122	$3,496

Save the Date!

EIS ANNUAL PAC CONFERENCE | October 26 – 29, 2020
Sterling Hall | Hyatt House | Hyatt Place
Downtown Historic Charleston, SC

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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."