



NASCA

National Association of
State Chief Administrators

INNOVATIONS
IN STATE
GOVERNMENT

State of State of South Dakota

Bureau of Administration

2019 Innovations in State Government

Captive Insurance Companies
Financial Management



Executive Summary (10 points)

South Dakota Bureau of Administration Office of Risk Management

Captive Insurance Companies

The State of South Dakota found it was having difficulty finding and/or affording property and casualty insurance for its buildings. To manage the process, the State passed legislation that allowed state government to become its own insurance company. As a result, the State of South Dakota created three captive insurance companies. The South Dakota Captive Insurance Companies include: South Dakota Authority Captive Insurance Company, LLC (Authority Captive), South Dakota Property and Casualty Captive Insurance Company, LLC (Property Captive) and South Dakota Trust Company Receivership and Liquidation Captive Insurance Company, LLC (Trust Captive). The first two Captives were organized in 2015 while the Trust Captive was organized in 2016. The three Captives were developed as manager-managed non-profits to insure the risk and provide affordable insurance. The formation of the Captives has had significant financial and operational impacts for the members. With the Authority Captive, the six South Dakota Authorities now have coverage for Directors and Officers, Errors and Omissions, and Commercial General Liability where they did not originally have coverage in their commercial policies. The Property Captive now insures all State-owned buildings over \$100,000, as well as contents, at replacement value. Prior to the Captive, only bonded and revenue producing buildings were insured by the commercial policy. The premiums for both the Authority and Property Captives are significantly lower than what was being purchased commercially. The Trust Captive was the first of its type to be formed. It is designed to cover the expenses of trust companies that have gone defunct. The unique construction of the Captives has made a notable difference in the cost of insurance where the savings can be passed on to the taxpayers.

Innovation (30 points)

Before the formation of the three Captives, insurance coverages were limited and increasingly expensive. In the case of the South Dakota Authorities Captive, each South Dakota Authority purchased insurance coverage independently prior to the Captive. The limits and types of coverage also varied. Prior to the South Dakota Property Captive, only bonded and revenue producing buildings were insured. Prior to the South Dakota Trust Captive, the South Dakota Department of Labor and Regulation absorbed the costs associated with closing trust companies out of their budget.

South Dakota Authority Captive

Since the formation of the Captives, each of the South Dakota Authorities in the South Dakota Authority Captive are now insured with the same limits and increased coverage. The premiums each authority pays, now determined by an actuary, are lower than what was paid prior to the Captive. The Captive has two cells that share services. The cells are treated as separate entities for risk sharing purposes.

The Captive provides general liability (CGL), directors and officers liability (D&O), public officials errors and omissions (E&O), and employment practices liability (EPL) coverage to all authorities. General liability for South Dakota Science and Tech Authority (SDSTA) includes coverage for general liability claims arising from experiments. Pollution liability is not covered by the Captive. All policies are written on an occurrence basis. The Captive also provides three years of retroactive coverage for all Authorities for D&O, public officials E&O, and employment practices liability.

Effective 01/01/2016, SDSTA's general liability exposures required a separate tower: Cell 1 for general liability other than that associated with additional insureds and Cell 1A (the Tower) for the additional insureds' exposure. Separate general liability policies are issued for each.

The exclusion regarding professional services in the Employment Practices Liability and Errors and Omissions insurance policy was changed effective 01/01/2016 to **not** include "any professional services provided by an employee of Entity acting for or on behalf of Entity in the course and scope of the employee's employment with Entity". The exclusion was removed so that those employees of SDSTA who have their Professional Engineer (PE) designation would be covered while providing professional services to SDSTA. SDSTA did not have this coverage previously.

South Dakota Property Captive

Similarly, since the formation of the South Dakota Property Captive, over 1,100 state-owned buildings and the state-owned contents of those buildings are now insured. There is a \$50,000 deductible per occurrence and the Captive covers the next \$450,000 of the claim. Reinsurance then covers anything above \$500,000. There is replacement coverage for both the property and the contents. The Captive also provides \$10M Extra Expense and \$40M Business Income, and Boiler and Machinery coverage which is included in the rate. As of January 1, 2017, the Captive is insuring only the State share of Department of the Military property. To date, there is not another insurance company that is insuring percentages of buildings. In the event of a loss at a Department of the Military property, the Captive will only be responsible for the cost share portion that is listed on the Statement of Values that had been provided to the Captive Manager before renewal and is shared with the

underwriters. Each insured building has also been through an appraisal process, making the State of South Dakota's insured buildings the most accurate in the underwriter's portfolio.

South Dakota Trust Captive

At the time of its conception, no other state specifically recognized the formation of trust captives. Because of this, the South Dakota Department of Labor and Regulation had to have the manuscript for the Captive written when forming the Captive. The coverage the State receives from the Captive is a major enhancement from the previous self-insurance approach. By purchasing reinsurance, the Captive is making better use of the fee revenue set aside by the Division for receivership and liquidation risks. The Division has had only one trust company failure to date, which occurred in 2003. Following that event and prior to the Division's efforts to establish the Captive, there was no commercially available coverage for trust company receivership and liquidation costs. The Captive will provide long-term coverage to the Division for trust companies that are granted perpetual charters, many of which will operate for a very long period of time. In addition, the use of the Captive will lead to consistent claims administration and substantial cost savings over the commercial insurance markets due to the unique nature of the risks being insured and the lack of commercially available coverage.

Transferability (30 points)

The formation of the Captive Insurance Companies has allowed for significant savings by the State of South Dakota and the South Dakota Authorities. Captives can be diverse and can be customized to accommodate the insurance needs of any state. States would need to evaluate their current insurance laws to allow for the formation of the governmental captive and design them to meet the needs of the state. Captives utilize actuaries to determine reserves and can be a safer and more effective way to manage state risk and resources. The cost benefits of a captive can be seen almost immediately.

Efficiencies Created (30 points)

Each Captive has allowed for more coverage for each entity at a lower rate. Each Captive is a private, non-profit LLC managed by a board of managers. Each Captive also has a Captive Manager located within the South Dakota Office of Risk Management. Having all the insurances centrally located allows for more negotiating power with underwriters. Each Captive is also managed in the same manner eliminating inconsistencies and reduces overhead and administrative costs.

With the formation of the captives, the South Dakota Science and Tech Authority (SDSTA) is now able to comply with all insurance requirements. SDSTA now has the ability to take on additional exposures with an expansion project in conjunction with Fermi National Lab. When comparing the amount of premium paid by the Authorities in 2014 before the formation of the Captive and the premiums paid in 2019, the Authorities have saved 44% for more coverage. The South Dakota Property Captive now insures buildings that were never insured before, including the State Capitol. The coverage allows agencies to replace or fix damaged buildings without going to the Legislature to have funds appropriated. The Property Captive has seen similar cost savings. The premium rate has decreased 58% from 2014 to 2019. The value of insured property has more than doubled since 2014, but the premiums paid has only increased \$250,000 since 2014 before the Captive was established. With the formation of the South Dakota Trust Captive, the Department of Labor and Regulation no longer self-insures the risk of failed financial institutions.