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# INVESTING IN RESILIENCE: A STRATEGIC LOOK AT RETENTION FINANCING

Property Practice

Climate shifts, operational delays, dynamic and fluctuating markets — businesses in the real estate sphere are no strangers to risk. Historically, businesses have relied solely on traditional insurance models to mitigate these risks. However, with rising premiums and shrinking coverage, many business owners are intentionally or unintentionally holding onto more retained risks on their balance sheets.

More businesses are actively stepping into the driving seat and absorbing manageable risks — a shift that should be viewed as a proactive stance in risk management. By way of example, a firm might choose to retain the risk associated with minor water damage to allow insurance to cover larger, less frequent events like flooding. This allows CFOs and risk managers to regain control, optimizing capital, and building a forward-looking strategy that works, even when market conditions are challenging.

This is where Retention Financing Programs (RFPs) would come into their own, offering a structured policy to manage these retained risks. Unlike ad hoc self-insurance and reactive budgeting to manage retained risk, RFPs are designed to help businesses fix the cost of retention over a longer period and protect against the downsides of retaining risk. Thus, providing budgetary certainty while removing volatility through a cost-effective financial mechanism. RFPs also include a significant profit-sharing element, enabling businesses to share underwriting gains when losses are lower than expected, thereby turning risk management into a potential source of financial upside.

In this whitepaper, we explore how RFPs can help businesses take control of their retained risks, optimize capital deployment and build financial resilience to navigate today's increasingly complex risk environment.

## UNDERSTANDING RETENTION FINANCING PROGRAMS

RFPs are a specific form of aggregated (re)insurance designed to manage retained risk sustainably. Typically, these plans are structured as multi-year contracts combining risk transfer and risk funding elements into a single, cohesive solution.

RFPs create a shared-risk model, where the insured retains a portion of the exposure while using the program to finance it in a disciplined manner. This ensures budgetary and cash flow stability, with the added benefit of potentially covering otherwise uninsurable risks.

### How RFPs operate

While each RFP is bespoke and designed to reflect the insured's distinct risk landscapes, the underlying framework remains similar.

RFPs are typically structured as 3 to 5-year policies with an annual and a term aggregate limit, covering a pre-defined range of retained risks. A significant portion of each annual premium is allocated to an experience account — a real or notional account managed by the (re)insurer on the insured's behalf. This account accumulates with each premium installment, earns interest or investment income, and is then used to pay claims within the defined retention layer.

RFPs provide two forms of protection to this experience account:

- **Credit:** Should claims exceed the balance of the experience account, the RFP Insurer will cover the balance of the claim up to the limits of the policy.
- **Risk transfer:** Should claims over the entire policy period exceed the insured funding obligations to the experience account, the RFP will pay all claims in excess of this amount, up to the limits of the policy.

If the total claims are lower than expected, any unused balance remaining in the experience account will be returned to the insured as a profit-share.

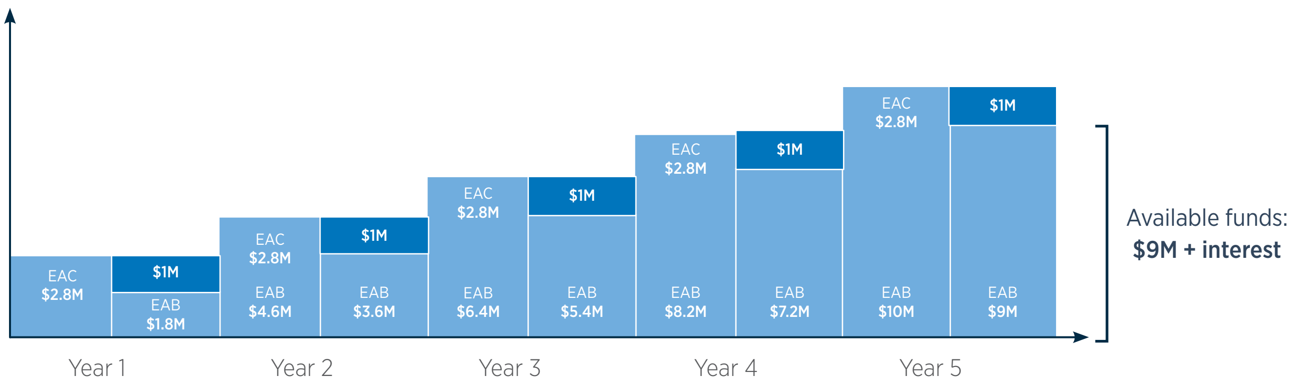
> "Beyond RFPs, clients can either retain the risk on their balance sheet, set up a captive insurance company or look at traditional solutions like deductible buy-down policies. However, these options come with their own challenges, such as volatility, market conditions and capacity availability, capitalization and solvency requirements."

**Joe Filby**
Director, Alternative Risk Transfer
Gallagher

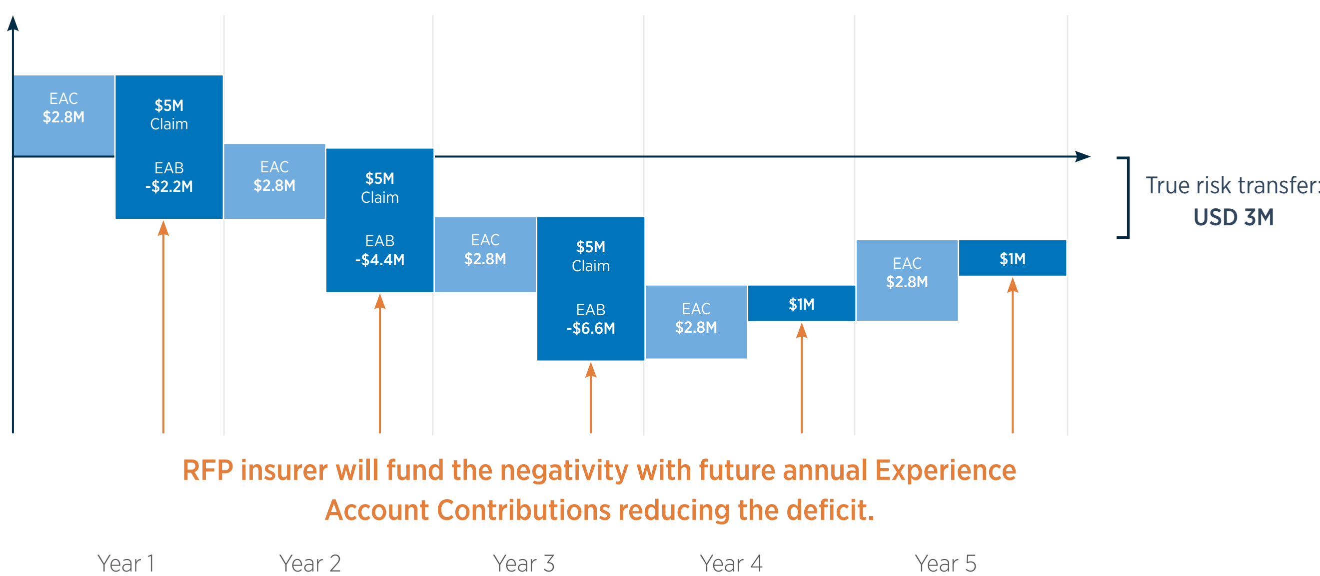
## RFPS IN ACTION

The following diagrams demonstrate how an RFP would perform under different loss scenarios, with Experience Account Contributions being made annually and claim payments being deducted as they fall due.

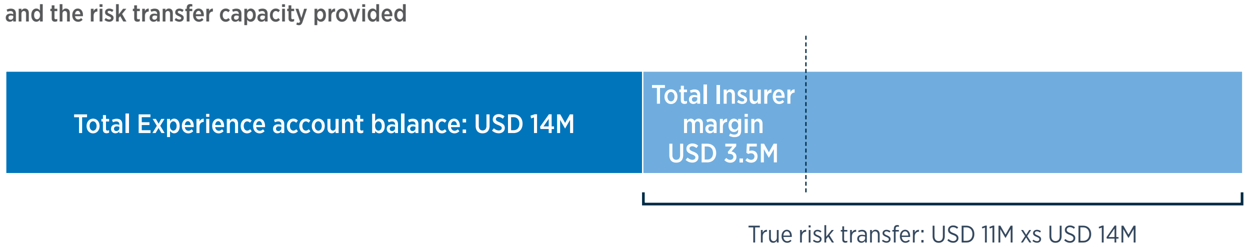
**Annual development of a 5-year RFP absorbing expected annual losses of USD 1M**




**Annual development of a 5-year RFP when absorbing catastrophic losses in years 1, 2 and 3 with expected losses of USD 1M in years 4 and 5**




**5-year cumulative position of the RFP demonstrating total funding obligations, the external cost of the Insurer margin and the risk transfer capacity provided**




In this example, if losses are under USD 14m over 5 years, there will be a profit commission due to the client equal to the remaining balance of the Experience Account. If losses exceed USD 14m over 5 years, there will be no profit commission but additional claims will have been paid by the (re)insurer at no additional expense to the client.

## THE STRATEGIC UPSIDE: BENEFITS OF AN RFP

RFPs provide insureds with an A-rated insurance policy that provides budgetary stability, removing volatility from the balance sheet of the insured when retaining significant levels of risk. Additionally, RFPs also bring a strategic edge to how risk is funded, managed and potentially monetized over time.

### Long-term stability against risk exposure

With policy terms typically spanning 3-5 years, RFPs offer budgetary stability in a volatile insurance market. These contracts are non-cancellable by the Insurer, offering security even in adverse loss years, yet remain adaptable to the insured's benefit, empowering organizations to plan and adapt proactively.

### Capital relief

In cases where the RFP is written as a reinsurance of a captive, the program can be used to provide capital relief. This can enhance solvency and support other retained risks. It can also be leveraged for wider, enterprise-level purposes, thus enabling companies to do more with the same risk funding over time.

### Profit participation and return potential

A cornerstone of RFPs is their ability to return value to the insured, with most of the RFP annual premium contributing to the insured's experience account. Upon commutation of the RFP, any funds remaining in this account, after all claims have been paid, can be returned to the insured. This turns what is typically a sunk insurance cost into a recoverable performance sensitive investment.

### Time to respond to emerging risk

Should retained losses trend higher than expected, RFPs can provide breathing room for management. With a locked-in pricing and limits of liability, insureds are given peace of mind, knowing that their claims will be paid in full by the RFP, with the insurer providing the balance of claims should they exceed the balance of the experience account. This inbuilt credit facility allows the insured to focus on recovering from the loss, without having to source additional funds to cover the retained exposure. Additionally, losses do not impact RFP premiums in future years, removing the pain associated with annual renewals following a difficult year.

With this protection in place, leadership has time to evaluate and restructure, to adapt to a changing environment and prepare for the future.

### Security in difficult-to-place markets

RFPs are particularly beneficial in distressed insurance market segments. They are essentially tailored to each client's risk profile, allowing companies to achieve financial stability and capital efficiency, especially where traditional insurance coverage is prohibitively expensive or unavailable.

## POTENTIAL TRADE-OFF CONSIDERATIONS

While RFPs offer strategic advantages, they come with certain challenges, including:

- **Not a replacement for low-cost insurance:** RFPs are not designed to compete with inexpensive traditional insurance. They are most effective when standard market coverage is limited, volatile or overpriced.
- **Multi-year premium contract obligations:** Regardless of loss experience, premium payments are often obligated to continue for the contract duration, requiring firm commitment from both finance and leadership.
- **Collateral requirements:** Should credit protection be required, with the experience account going into a deficit, the (re)insurer will pay claims to the full extent of the RFP limits. They may however, request collateral to the extent of the deficit, such as a letter of credit, to manage credit risk. Collateral required will never exceed the total of any remaining premium obligations.

## WHERE RFPS SIT IN A LONG-TERM RISK STRATEGY

Beyond their immediate financial benefits, RFPs align well with long-term financial planning and enterprise risk management. Over time, these programs can evolve to be a part of a broader risk financing strategy.

### Aligning capital efficiency with risk objectives

By providing a predictable, controllable mechanism for retained risk, RFPs align insurance strategies with capital allocation goals. They support multi-year planning, reducing volatility in operating costs. ROI is measured by long-term improvements and a good risk performance is positively monetized, thus feeding back into capital efficiency metrics.

### Structured review and adaptation

Once implemented, RFPs provide insureds with a long-term insurance backed tool to manage retained risk. But while their terms are outlined at inception, insureds have the flexibility to conduct a strategic review of the RFPs performance at each anniversary. During this review it can be considered if the RFP is still fit for purpose or if amendments to its structure are needed to maximize the benefits provided. Key questions to consider at this stage include:

- Is the RFP still aligned with business and risk goals?
- Is the RFP structure optimized or should it be restructured or repurposed?
- Have new issues emerged since the RFPs implementation which could be resolved through the RFP mechanism?
- What is the optimal use of the Experience account that develops over time: reinvestment, return or redeployment?

### Flexibility at maturity

When RFPs reach maturity, insureds can choose how best to use the closing experience account. It is essential to factor in tax implications and capital needs into this review and the return of the experience account should be done in a tax-efficient manner. Alternatively, the experience account can be reinvested into supporting a new RFP, providing insureds with a new multi-year horizon for their risk retention strategy.

## EVALUATING YOUR FIT: KEY CONSIDERATIONS FOR A SOUND RFP STRATEGY

RFPs help turn retained risk into an asset — one that is forecastable, fundable and, when well-managed, financially advantageous. However, the decision to implement an RFP should be anchored in financial logic and operational readiness, not just market conditions or insurance availability.

Here are the key points to determine if an RFP is the right fit for your firm:

**Cost of capital vs. benefit of liquidity**

While RFPs provide long-term budget stability, they come with structured funding commitments that may exceed traditional premium figures. Insureds must assess whether the value of liquidity and potential for significant profit-sharing justifies this increased, up-front cost. This trade-off could be a limiting factor for capital-constrained companies or those with more immediate priorities.

**Creditworthiness and underwriting assessment**

RFP providers evaluate the insured's financial strength, risk maturity and historical loss experiences — and not all businesses may qualify. Since underwriting rigor is essential for the plan's sustainability, the better the data, the more flexible the RFP structure can be.

**Internal alignment**

A successful RFP demands cross-functional alignment, particularly between finance, risk, legal and treasury. Companies with a mature risk management function and stakeholder alignment to retain risk, are best positioned to leverage RFPs to their advantage.

**Compliance considerations and commercial viability**

While it is essential to consider regulatory, tax and accounting implications from the outset, it is crucial to assess the deal's commercial viability first. Once the risk profile, financial benefits and the structure of the RFP make sense commercially, the compliance components should then be addressed in close consultation with the business auditors and legal counsel.

## WHEN RFPS MIGHT NOT BE THE BEST FIT

While RFPs offer significant value under the right conditions, they may not be suitable when::

- Retained risk exposure is low, and the program's benefits are unlikely to outweigh its costs.
- The business has a limited appetite for multi-year financing commitments or anticipates structural changes soon.
- Traditional markets are still providing cost effective capacity.

> "The program should fit within the client's risk management practices and evolve along with their specific situations as well as market conditions. Clients should also be aware of expected growth and any significant changes on the horizon. These programs are typically not for smaller clients with low insurance costs and generally suit those with annual insurance spends above $10 million, where the scale justifies the structure and cost."

**Joe Filby**
Director, Alternative Risk Transfer
Gallagher

# Does RFP support your risk and capital goals?

## A QUICK VISUAL CHECKLIST

**Retained risk exposure**

- ✓ Aligned appetite to retain exposure amongst stakeholders?
- ✓ Reliable historical loss data for plan modeling?

**Capital impact**

- ✓ Earning volatility due to risk retention?
- ✓ Pressure on reserves due to unpredictable risks?

**Insurance gaps**

- ✓ Limited market coverage?
- ✓ Exorbitant pricing?
- ✓ Exclusions?

**Strategic fit**

- ✓ Businesses in changing risk exposure mode (i.e., expansion, mergers, acquisitions)?
- ✓ Evolving risk profile due to business strategy/business model?

## CASE STUDIES: RFPS IN ACTION ACROSS THE GLOBE

**Resisting a hard market: A global hotel chain's response to rising premiums**

Following 9/11, a major international hotel chain was met with steep premium hikes despite a good claims history. Rather than absorbing the market's increased pricing, the business decided to raise its captive retention level and use an RFP. The company preserved market capacity at the same cost and leveraged RFPs to protect the additional risk exposure. The cross-class aggregate structure covered multiple lines of risk, while a profit-sharing element (up to 90%) ensured value return in the absence of major losses. Over three years, the program handled around $57 million in premium volume, delivering both protection and budget certainty during one of the toughest insurance markets in memory.

> “RFPs became popular during tough US property market conditions, for good reason — it’s about certainty and peace of mind. They offer a cost-effective way to retain more primary risk and spread it over time, offering clarity on business risk exposure. Moreover, the ROI is measured by long-term improvements, reduced volatility and the ability to recover a large portion of premiums when risk performance exceeds expectations.”

**Joe Filby**
Director, Alternative Risk Transfer
Gallagher

**Financing uninsurable risks: A South African mining group’s journey**

Facing high premiums and a deteriorating loss experience, a South African mining company turned to an RFP solution to regain control. The program was paired with a strategic internal risk management initiative to reduce losses.

With the RFP in place, they increased their property damage and business interruption retention providing long term stability within their insurance program and over time, the company evolved into one of the best-managed mining risks in the market. The RFP then expanded and was even used to secure coverage for traditionally uninsurable exposures, including environmental impairment liability and silicosis. This has resulted in the company now funding its full legal obligations to workers for historical silicosis claims directly from its insurance structure without impacting the P&L. No other peer in the industry has been able to match this level of self-sustaining risk financing.

## MAKING THE CALL WITH GALLAGHER: YOUR PARTNER IN STRATEGIC RISK FINANCING

Choosing the right retention strategy is a significant decision. It can shape your organization’s financial stability and long-term resilience and bring insight, innovation and certainty to your risk-financing journey. At Gallagher, we go beyond traditional insurance by helping clients design and implement retention financing programs built to perform.

### WHAT WE PROVIDE

- Tailored risk evaluation
- Custom programs
- Expert negotiation
- Continuous oversight
- Education and enablement
- Claims and modeling support

By assessing your unique risk profile and loss history, we can determine the optimal retention levels for your business. From structured RFPs to self-insured retentions and captive solutions, we create custom strategies aligned with your goals.

We advocate on your behalf to secure the best terms and pricing from the market and conduct ongoing program reviews to ensure the plan evolves with your business and remains fit for purpose.

We also work closely with your teams to build an internal understanding of retention strategies and complexities. Finally, our financial modeling tools and claims expertise help forecast outcomes, enabling you to manage retained exposures effectively.

Let's start a conversation. Contact Gallagher to learn about our solutions to protect your organization and improve your balance sheet.

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