FEATURE

GROUP CAPTIVE MARKET THRIVING

Written By Caroline McDonald

As more organizations become aware of the benefits of participating in a captive, the number of group captives being formed has steadily increased.

The current hardening in the traditional insurance market makes them even more attractive and shows that the captive industry will continue to grow.

Captives are an excellent way for organizations to have ownership in their own insurance program. With insurance costs increasing in all areas, they can have control over the outcomes of their property/casualty insurance coverage, targeting auto, general liability, and workers compensation.

"A group captive is a better, more engaged risk pool for the group to share risk with," said Duke Niedringhaus, senior vice president at Marsh & McLennan Agency. "If you go back to the history of insurance, you might not know who you are sharing risk with if you're with an insurance company." The reality, however, is that "you are sharing risk with the overall market."

Another reason for the growth of group captives is that they are more and more accessible to smaller companies.

"There are many group captives with accounts that are $100,000 in premium size now, and 30 years ago, that was unheard of," said Arthur R. Collins, captive segment leader and managing director at Guy Carpenter. "The risk-taking appetite and the knowledge of captives was in its infancy, and it was a product designed for larger businesses that had financial wherewithal to understand and retain risk."

Now that group captives are recognized as sustainable solutions for businesses of all sizes, the barriers to entry are low. A great benefit of a group captive, particularly for smaller entities, is that they share loss control and best practices information with other businesses to contain losses and improve safety for employees," Collins said.

The captive industry, Niedringhaus noted, was created in the mid-1980s, "and it took the industry 15-20 years to hit $1 billion in premium. Now, you could easily see $500 million a year going into this segment of the captive market."

Including all captive managers, he said, "It's probably $7 to $8 billion in premium. At this level, it's starting to impact the market and how carriers are positioning themselves."

WIDESPREAD BENEFITS

The Insurance Information Institute, in its report, "A Comprehensive Evaluation of the Member-Owned Group Captive Option," highlights another benefit of captives: the advantage of direct access to reinsurance:

> A captive can go directly to the global reinsurance market and purchase coverage at wholesale rates because it is essentially an insurance company. Further, the price for reinsurance coverage is driven by the captive's own exposures and loss record, not the experience of the industry. The captive does not have to work through a commercial insurer for this access and thus saves on the expenses associated with dealing with commercial insurers – e.g., commission costs, administrative costs, and profit markup. Member companies retain much more control over the selection of and arrangements with reinsurance partners.

Reinsurers also benefit from doing business with group captives. "The ability to target these opportunities is somewhat limited, in that the policy-issuing company needs to have unique capabilities and expertise to properly service the captive," Collins said. "This includes policy/regulatory administration, claims oversight, unique underwriting expertise, collateral management and reinsurance/excess capacity management. It takes time to develop this type of platform, which results in highly serviced, durable reinsurance partnerships."

Ultimately, captive owners and insurers have "a shared desire to maintain stable partnerships over longer periods of time. This helps to ensure stability in the event of an unexpected loss and to keep collateral at manageable levels over time," Collins said.

RISK CONTROL DRIVES PROFITS

Key to a profitable captive is risk control.

"With group captives, you're sharing risk with a better, more engaged risk pool," Niedringhaus said. "They work well, whether they are homogenous or heterogenous." He added, "The common theme is best-in-class engaged owners, a great safety culture and very engaged in managing risk."

For example, he said, "Statistically, the fatality rate for workers' comp claims in group captives is about 50 percent of statistical averages. Of all the compelling statistics of the group captive, that is at the top."

The reason, Niedringhaus said, is "attention to risk management: Don't have the claim in the first place."

GROUP CAPTIVE HEADWINDS

While the market is climbing, there are some events that can throw a curve, Niedringhaus said. These are:

Acquisitions: Typically, a national company or private equity company will buy out a mid-market account. If the account is with a group captive, it will often get rolled into a national program, or the private equity will pull it out of the group captive.

Property insurance: It's so challenging that it can dictate the overall program placement. So, if you've got one insurance company writing all lines of coverage, including property, and you want to take the casualty lines and put them into a group captive, the market pain of buying property coverage alone might prevent a company from joining a group captive.

Umbrella placement: It can also be a headwind for a company to join a group captive and break an insurance company partnership, where the insurer is providing all lines of coverage. To take umbrella out of a total program with one insurer is a headwind, Niedringhaus explained.

A CAPTIVE OWNER'S PERSPECTIVE

Dwight Werts, second-generation owner of Werts Welding & Tank Service, Inc., has been a member of Archway captive in St. Louis for ten years. The captive was started in 1994 and has 300 members.

"Our company is 66 years old, and I am the second generation. My dad started the business, and my son is also involved," he said.

Businesses in the captive, Werts said, include temporary staffing companies, lumber yards, and trucking businesses. Also, part of his captive are four of his customers in the tank truck fuel oil delivery business.

What led him to a captive, he said, was the annual meetings with their insurers to discuss coverage.

"They would always come in at the last minute and say 'Here's your renewal, it's the best we can do, it went up another 25 percent. If you'd like to shop and look around, you've got three days.' We just kept seeing our rates go up and we had no control over it," Werts said.

"Insurers say to keep your losses down, and that's how you control your rates," he explained. "One year, we had no claims, and our rates went up. I asked how our rates could go up without any claims, and they said, 'That's the market.'"

That was when he realized that "A lot of the rate increases had nothing to do with our industry or our safety record. It was about their investments in the marketplace. We felt helpless."

Added to this, he said, was his experience as a pilot, flying his own plane to visit the company's eight branches in the U.S.

"One year, they said that the reason we had so much rate increase was because of our airplane, that we were flying employees, and if there was an accident, there would be a workers' compensation claim."

Eventually, he stopped flying and sold the plane. "I had to sign a document that I would not be flying it or flying employees anymore," Werts said. "The next time the rate came in, I had an increase. They said, 'Well, it's the market.' That's when it really hit me that it wasn't working."

Once he began looking into the captive market, "I talked to people and found out there were more people in captives than I realized," he said.

The company is now part of a group captive for workers compensation, liability and automobile. "There are all types of business in our captive. Many different industries in many different states." Werts said.

Being part of a captive has been a good experience, he said. "We get a nice check back every year because we keep our claims down. If you play well and you have a good record, you get rewarded. We also work with a reinsurer through our captive."

Part of keeping claims down, he added, is the commitment to safety. As an example, "We got our people on board, and we have safety programs and meetings. We just had CPR and defibrillator training for all our employees," Werts said. ■

Caroline McDonald is an award-winning journalist who has reported on a wide variety of insurance topics. Her beat includes in-depth coverage of risk management and captives.