GROUP CAPTIVE FACTS AND FALLACIES

Key facts and benefits of member-owned group captives were discussed at the recent 2012 Cayman Captive Forum

BY MICHAEL KILBANE, president and NICK HENTGES, executive vice-president, at Captive Resources

The recent 2012 Cayman Captive Forum held in late November, included a session titled *Member-Owned Group Captives – Facts and Fallacies* presented by principals of Captive Resources LLC, and a long-time group captive member-owner. The session presented key facts and benefits of member-owned group captives and dispelled several misconceptions as well.

The session was presented by Michael Kilbane, president of Captive Resources, Nick Hentges, executive vice-president – sales at Captive Resources, and John Arnold, owner and CEO of Petroleum Products Corporation, a long-time member and past president of Raffles Insurance Ltd., Captive Resources' oldest and largest captive.

A balanced view of heterogeneous versus homogeneous programmes, small versus large versus 'mega' captives, and how captives with many members can work well together via an efficient and productive committee structure, was presented. This article will provide highlights of the session which was presented in a question and answer format.

"Member-owned group captives are a fast growing segment of the market." – Fact or Fallacy?

Nick Hentges pointed out that member-owned group captives have grown from about $100m in written premium in the early 1990s, to over $1.3bn now, an increase of 1,300%. He said that the number of captives generating that premium had grown steadily over the same period, with the number of their member-owners growing from about 400 to at least 4,000. He added that what's really significant though, is that much of this growth — upwards of 70% of the current, total estimated premium volume — has come in the last ten years or so. Hentges concluded saying that nearly all Captive Resources' (CRI) captives have experienced very strong growth over the past two to three years, and that the expansion in the group captive sector, has only served to increase the accessibility of captives for mid-sized companies.

"Member-owned group captives are designed for large, well-capitalised Fortune 1000 type companies." – Fact or Fallacy?

Mike Kilbane, also serving as session moderator, asked John Arnold to address the question. Arnold took the position that this is both fact and fallacy. He explained that there is no reason why member-owned group captives should be limited to Fortune 1000 type companies, and that in fact, a significant portion of middle market America, with wide ranging premiums, both public and private companies, can benefit from membership in one. He went on to add that the capital and collateral requirements are also very compelling for many mid-size companies. The collateral required by a CRI captive is formula driven and spans a three year period, rather than being determined by the policy issuing carrier and often stacked for many years with no input from or control for the insured.

"Member-owned group captives are designed to assume only limited risk and have a low risk tolerance." – Fact or Fallacy?
Nick Hentges stated that this is a complete fallacy, and that assumption of risk is not limited when best-in-class companies are recruited for membership. He added that many challenging risks have had great success in group captives. There are several industries that are widely perceived as difficult risks that have successful, well-established group captives, including trucking/transportation, construction, roofing, temporary employment services, oil field operations, ready-mix operations and agriculture. Keys to success include selecting companies that are truly committed to safety and loss control, and then designing industry-specific risk management programmes that better enable them to limit their loss exposure and mitigate losses that do occur.

"Member-owned group captives domiciled in the Cayman Islands have met all international guidelines for accountability." – Fact or Fallacy?
Mike Kilbane addressed this matter on several fronts and stated that it is emphatically, a fact. He noted that the International Monetary Fund (IMF) and the Financial Action Task Force (FATF) deemed the Cayman Islands to be in full compliance with all international mandates. The Internal Revenue Service (IRS) definitions of a true insurance company are fully met by all CRI captives; the Cayman Islands also has full income tax transparency with the IRS. Additionally, the Cayman Islands currently has tax information exchange agreements (TIEAs) with 27 other countries which exceeds the number required by the Organization for Economic Cooperation and Development (OECD).

> **"IT DOESN'T MATTER WHERE YOU DOMICILE YOUR CAPTIVE - FACT OR FALLACY?"**

"Member-owned group captives are best suited for specific industries (i.e., are optimally, homogeneous)" – Fact or Fallacy?
John Arnold was asked to respond to this question. As a very early member of Raffles Insurance Ltd., a very large, heterogeneous captive, John was clear in his position that this is a fallacy. He acknowledged that there are benefits offered by both homogeneous and heterogeneous captives and that one is not necessarily better than the other. He explained that there are certain aspects of a heterogeneous captive that appeal to him, including a greater spread of risk due to geographic and industry diversity; lower cost of reinsurance as a result of market leverage that a larger captive typically offers (heterogeneous captives typically grow more readily, simply by virtue of a larger universe of potential members); and the synergies of like-minded business people across a wide variety of businesses, sharing risk management information and ideas, irrespective of industry.

> **"MEMBER-OWNED GROUP CAPTIVES ARE A FAST GROWING SEGMENT OF THE MARKET - FACT OR FALLACY?"**

"It doesn't matter where you domicile your captive." – Fact or Fallacy?
Mike Kilbane responded, indicating that this is of course, a fallacy. He noted that CRI believes choice of domicile to be critically important, and further reflected on the reasons why all CRI group captives are domiciled in the Cayman Islands: the Cayman Islands have a financial infrastructure second to none, with first rate captive insurance managers, top flight accounting firms including the Big 4, a strong and significant banking presence, top tier legal firms, and deep insurance expertise. Additionally, he noted that regulatory support for the captive industry is strong and efficiently managed by the Cayman Islands Monetary Authority (CIMA), and promulgation of business-focused regulation.

"Member-owned group captives provide better predictability than the standard insurance market." – Fact or Fallacy?
Arnold began the discussion by indicating his belief that this is true, based on his company's experience as a long-time member/owner of a group captive. He pointed out that member-owned group captives are interested in best-in-class companies that are focused on gaining control of the insurance process and greater leverage in the insurance market. Arnold noted that captive members have strong incentive to proactively manage loss control and claims because of their ownership stake in the captive. Actuarially developed premiums based on members' own losses, the shifting and sharing of risk with like-minded, safety-driven co-owners, specific excess reinsurance, and aggregate stop loss that defines maximum liability, all contribute to increased predictability of premiums.

Benefits of group captives

In conclusion, Kilbane noted that mid-size companies can benefit from participation in a member-owned group captive in a number of ways including the control afforded them to manage their risk more effectively, while improving risk management practices, achieving greater predictability of premiums versus the traditional market, and having underwriting profit returned to them. He also noted that member-owned group captives have seen robust growth in both hard and soft insurance cycles, and have a proven track record of success over the last thirty years.