MID-SIZED ACCOUNTS MOVE INTO THE ART MARKET

Opportunities for independent agents abound

Middle market accounts are continuing to take advantage of a variety of alternative risk transfer options, including captive insurance companies. They are seeing the benefits of captive ownership and are utilizing group captives as a mainstay for their long-term risk financing needs. For most industry observers, this is no news flash; this movement has been apparent for the past eight to ten years. However, for some, such as George Rusu, co-founder, chairman and CEO of Captive Resources, LLC (CRI), this is a phenomenon that started more than 25 years ago.

For Rusu, and his team at CRI, it started when they began work on Raffles, a member-owned captive, in the mid-1980s. "Up to this point," he says, "the majority of captive formations were generated by Fortune 500 companies." During this time, CRI "became aware that group captives' needs were significantly different than single parent captives'." Accordingly, CRI built its business model on assisting these group captives and in the process has managed to grow Raffles into the largest heterogeneous, member-owned captive, and has also started more than 25 other group captives. Currently, Rusu points out, "CRI captives include over 2,400 owner/members."

Initial concerns

While some of the group captives that came out of those early years were successful, Nick Hentges, executive vice president and sales manager, says, "CRI noticed a flaw in their structure." He says that, too often, once they were formed, "They depended on the CFO/CEO of the member companies to come together a couple of times a year, at the shareholders meeting, and run the insurance operation." He says that for the most part, "This was a difficult, if not impossible task, for any group captive." It became obvious what was missing: "They needed someone to oversee the day-to-day business of the captive operations." CRI observed this shortcoming and set their sights on filling this void.

Another shortcoming had to do with the conflict of interest that frequently was built into most group captives. Ownership of the captive was frequently in doubt. Capitalization was

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Captive Resources executives (from left): Nick Hentges, Executive Vice President/Sales Manager; Jennifer Beard, Chief Operating Officer; and George Rusu, Co-Founder, Chairman and CEO.

provided from a number of sources, but rarely by only the members themselves. As a result, potential conflicts existed between the members and the providers of capital. For this reason, CRI chose to develop a business plan that incorporated only member-ownership captives.

Keys to success

Every successful captive has a number of factors that have helped account for its superior performance. One of the key factors that CRI points to is the selection of the captive's domicile. Domicile selection is a key consideration for any captive insurance company, and this was true with CRI's choice of the Cayman Islands. Rusu notes that after a review of potential domiciles, they decided that the selection of an offshore domicile would be the most beneficial for their purpose. After that, the selection of the Caymans centered on several important considerations, according to Jennifer Beard, CRI's chief operating officer.

First was the issue of capitalization. "The Cayman Islands allow for the use of letters of credit (LOCs) as part of a member's overall capital structure," Beard points out. And this is a big issue. "If you're a midsize manufacturer, for example, you can use an LOC to capitalize the majority of your ownership." From the start, the effective use of LOCs has proven to be a very significant advantage available from the Caymans.

One of the other major selling points of the Caymans, according to Rusu, was the vision provided by the original legislation. While the Caymans, like many other domiciles, has revised its legislation to take into consideration the changing requirements of regulators, its original legislation has remained intact. He says that this has shown that the domicile's long-term strategies about regulating captives have been correct and in sync with its initial vision.

Bottom line, all three of CRI's executives agree that "the Cayman Islands are in the business of wanting to help you start your captive." And while at the time (mid-1980s) the domicile was best known as a health care captive domicile, Rusu says, "They welcomed our group captives." Since working with CRI and several other organizations that specialize in group captives, the Caymans have become even more favorably disposed to group programs. And, CRI further notes that the Caymans are just plain "user-friendly."

Another key to CRI's success is the relationship it enjoys with its agency distribution system. From the outset, it was important that the insurance community understand that CRI's only business was captive oversight. Hentges is quick to point out, "We are not brokers, nor do we have any desire to be brokers." So for independent agents and brokers that are concerned about a captive consultant that could become a potential competitor, CRI is not involved with the brokerage side of the business, he says.

Today, CRI has relationships with more than 200 brokerage offices that provide prospects for CRI captives. Hentges notes that it's these 200-plus offices and CRI's continuing commitment to educating them and their prospects that has proven to be another factor in CRI's success.

Rusu concurs, indicating: "We have made a big commitment to our educational programs to the brokerage community, as well as prospective captive members." But it's this educational aspect that is at the core of both the initial conversation as well as the ongoing retention of members. Currently, CRI is maintaining an impressive 98.5% retention of business. It has found that companies that join the captives just don't leave. Not only do they stay in the captive, they also suggest the captive to their business associates such as suppliers, vendors, and customers, notes Beard.

What the future holds

The current soft market has caused some brokers to get a false sense of how the insurance market will affect captives going forward. Initially, many industry experts had predicted that captives would fall out of favor once rates began to soften. However, as the past several years have shown, this has not been the case. In fact, Rusu believes that the captive market is poised for explosive growth. He points out that as the economy continues to improve, companies will begin to see their exposure base grow as well. Increasing personal property values, payrolls, sales, etc., will cause a corresponding increase in premium. Further, since the organizations that typically gravitate to captives tend to be the better accounts, Rusu believes that they will be among the first to see this organic growth.

He also points out that over the past few years, many organizations have expressed an interest in the captive concept. However, these organizations have just been too busy to move to this alternative. As the economy improves, these organizations should be in better financial position to avail themselves of the advantages of a captive, but may still be too busy as they take advantage of the improved economy. Ruso says that this provides an opportunity to help them out.

Hentges also points out that recently there have been issues regarding the availability of capital which makes getting an LOC more difficult. But as capital becomes more plentiful, companies will be better able to obtain LOCs and thus become potential captive owners.

Conclusion

As noted above, CRI has more than 200 brokerage offices that are producing business for their various captives. However, they continue to welcome other brokers who have prospects for their captives. Mid-sized brokers would do well to consider a relationship with CRI. As almost every industry source has noted, growth within the alternative risk market over the past few years has primarily been driven by mid-sized corporations. Having the ability to offer a captive insurance company option can provide brokers with a well-needed product diversification for the challenges that lie ahead.

The fact that CRI's captives have been able to maintain a retention rate of over 98% speaks volumes regarding its success with captive members. An additional reason for CRI's long-term success has to do with the return of dividends to members. According to Rusu, CRI has been able to provide over $550 million in dividends since the captive programs started. But even more impressive, says Rusu, is the fact that, despite the state of the economy last year, dividends of over $100 million were returned to the captive owners. "Being able to return these types of numbers is really important to our member companies, especially in these difficult economic times."

CRI is set up to serve mid-sized brokers that are looking for ways to expand into the ART market without making a major investment of time and talent. With more than 25 years of successful experience, it has developed a formula that can assist these brokers in dealing with those mid-sized accounts that may wish to move to a more sophisticated approach to risk financing. ■