Business Insurance

Private company takes alternative route

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A company doesn't have to be a member of the Fortune 500 to take advantage of captive insurance. Ask David Bernstein, president of Mid-State Lumber Corp. in Branchburg, N.J., a privately held middle-market building products firm with approximately $100 million in annual sales and 95 employees.

Mid-State Lumber is a member of Grand Cayman, Cayman Islands-based Archway Insurance Ltd., a member-owned group captive that provides workers compensation, general liability and auto coverage to 105 midsize companies.

"Ten years ago, I read an article about captives and how they were becoming feasible for midsize businesses like ours," Mr. Bernstein said. "I spoke to our broker at the time and he said if he could get a group together, he would support it, but he struck out."

So Mr. Bernstein did his own research and found two group captives that his company could potentially join. He felt uncomfortable with the first, but a second captive composed of an assortment of construction, service and manufacturing companies that were more geographically dispersed appealed to him.

Mr. Bernstein said what he liked most about Archway was that it included businesses across the United States, none of which were Mid-State Lumber's local competitors or customers.

Ironically, Mr. Bernstein said he was introduced to Archway by Mid-State Lumber's bank, not its insurance broker, though the company today uses Wells Fargo Insurance Services USA Inc. to place several other lines of insurance that include employee theft and umbrella liability, in addition to Archway's coverage.

"We had been shopping insurance forever and the whole process is very grueling; it's not one you enjoy or control," Mr. Bernstein said.

By contrast, participating in a captive has been "a very good experience for us. They help us become a safer environment, which is good for our employees," he said. "I would say we were a pretty safe environment to begin with or we wouldn't have been invited to join Archway."

Archway, managed by Kensington Management Group Ltd. in Georgetown, Grand Cayman, a subsidiary of Captive Resources L.L.C., requires risk assessments prior to inviting a business to join, said Mike Kilbane, president of Schaumburg, Ill.-based Captive Resources.

Moreover, the captive has lowered Mid-State Lumber's risk-financing costs, Mr. Bernstein said.

Since its inception in 1994, Archway has returned $32.5 million to its members in dividends, which are paid in two situations: if a member's loss experience proves better than expected and/or if the group's overall loss experience is favorable, Mr. Kilbane said. In addition, funds deposited into the captive earn investment income, he added.

The insurance program financed by Archway actually is reinsurance. The participating members all receive standard $1 million insurance policies from The Hartford Financial Services Group Inc., which then cedes the primary $350,000 layer of each policyholder's coverage to the captive.

The way the excess $650,000 layer is financed depends on reinsurance market conditions, Mr. Kilbane said.

"Either the carrier takes the excess-of-loss layer or we go to the reinsurance market if the Hartford is not interested and see what the reinsurance market quotes for that layer," he said. "Or the Hartford and a reinsurance carrier will do a quota share, which is what Archway is doing now. The excess-of-loss layer is shared 50-50 with ACE Ltd. and the Hartford."

All captive members still pay premiums, which are calculated based on prior loss experience as well as a one-time $36,000 start-up fee, which is used to buy one share of captive ownership. Because captive members are, in effect, shareholders, they don't have insurance contracts per se. But they do have a legal commitment for a minimum of one year and become eligible for dividend payments after three years.

Because Archway is a group captive, most of the risks it finances are unrelated to an individual parent or member company, making premium payments tax-deductible for each company under Internal Revenue Service rules.

Meanwhile, all funds held by the captive are managed by the Captive Investors Fund, a proprietary Captive Resources' investment vehicle, and also by Hammer Asset Management L.L.C., Auburn, Calif.

Claims administration and loss-control services for captive members are provided by Gallagher Bassett Services Inc., a unit of Itasca, Ill.-based broker Arthur J. Gallagher & Co., which is paid out of premiums.

Captive Resources also employs loss-control engineers and claims advocates to oversee the third-party administrator.

Mr. Bernstein said he believes if more mid-market business executives were educated about captives, they would want to use them, especially because they can help to smooth the cost of risk financing regardless of insurance market conditions.

"The group has to do well, of course," he said. "But we're insulated from the impact of natural disasters and investment losses on an insurer's financial portfolio. We stand on our own merits."