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A Model for Policyholder Retention

Editor's Note: This is an interview with **Sandra Duncan**, vice president of operations at Captive Resources, LLC (CRI), in Schaumburg (sduncan@captiveresources.com). We found CRI's comprehensive and well-established business model enviable for many group captives that are currently dealing with loss of members. The long-term commitment of captive members involves much more in-depth involvement than many group captives. It makes for a good business model to study.

The 2011 Fronting Survey conducted by the Captive Insurance Companies Association (CICA) indicated that the number one challenge faced by its captive respondents is policyholder retention/growth. However, *CICR* was impressed with our findings from group cap-

tive specialist Captive Resources, LLC (CRI). It has beaten the trend with a 98+ percent member retention rate year after year in the captives it administers (with shrinkage usually as a result of mergers and acquisitions). We wanted to know how CRI has been able to do this in the face of an extended soft insurance market and difficult and stagnating economic conditions. Following is our questions and CRI's answers.

CICR: So, what is CRI and how have you managed to maintain your membership?

CRI: CRI is an independent consultancy formed in the early 1980s, specializing in creating and overseeing the operations of member-owned group captives. CRI is not a captive manager, nor does it provide broking services. While it does facilitate formation of group captives, to avoid conflicts of interest, it has no ownership interest in the captives it advises.

The answer to how we have managed to maintain our membership is embedded in the CRI business model, its execution and service delivery, and inherent added value that bolster its captives. There are a number of characteristics inherent in CRI's group captive model that positively impact member satisfaction. They range from the more concrete benefits, such as dividends and operating cost reductions, to the somewhat less tangible, such as the peace of mind that results from having sound captive policies and procedures in place that are de-

signed to ensure the overall financial health of the captive, such as the monitoring of individual members' financial position and periodic risk assessment. The model provides the captive owners many benefits, including long-term stability and cost control.

CRI currently administers 26 active captives with 2,500 member-owners and total premium of approximately \$900 million. Dividends of approximately \$700 million have been paid to member-owners since the captives first began, with over \$100 million of that paid out in 2010.

CICR: Was the significant amount paid in 2010 because of the tough economy on CRI's members?

CRI: No, that figure reflected the growth in the number and size of its captives over time, the increased maturity of those captives, and the effects of good loss control.

CICR comment: CRI's efforts appear to be deeper than most group captives that we have seen, compared to many group captives that do this perfunctorily through their often disengaged or minimally engaged captive managers. Can you describe some of these efforts that have worked well?

CRI: Member education is one. Adequately educating prospective members and providing for continuing education of members has been critical to the long-term success of CRI captives. To make sound decisions as insurance company owners, members must under-



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While it may seem rudimentary, education plays a very important role in the CRI captive model as education leads to understanding/knowledge, which in turn creates "buy in" and long-term commitment, which leads to the captive's growth and success.

~Sandra Duncan

stand the captive mission, risk funding formula, operations and various functional areas of the captive, finances, responsibilities of membership, and marketplace dynamics. Members feel empowered when they have a clear understanding of the mechanics and day-to-day operations of their captive. CRI works very closely with brokers to educate prospective members, so that incoming members are prepared for their role as insurance company owner and expectations are realistic.

Examples of educational initiatives include formal orientation for new members and regular refresher sessions for existing members, and mentoring programs to facilitate entry for new members. An understanding of the captive's purpose and clearly defining member responsibilities are particularly important to long-term member retention.

CICR comment: There is a very big difference between using a captive to reduce premiums versus running an insurance company. How does CRI convey its purpose to prospective members?

CRI: The foundation underlying the CRI group captive model is the captive's mission statement or purpose. The member-owners of CRI's first captive, Raffles (**CICR comment:** See the CICR October 2008 case study of Raffles), led the way by determining that Raffles would be a vehicle through which its members could control their own insurance destiny by eliminating the adverse effects of the cyclical nature of the insurance industry. It is critical that prospective members are educated in all aspects of the captive, but particularly so its mission, so that their expectations are appropriate. Members understand that:

- ✓ The captive exists mainly to provide long-term cost stability (which means that, in any given year, costs may be lower or higher than the market).
- ✓ The captive premium is derived from members' own experience (and, therefore, fully within their ability to influence and control).

- ✓ The operational costs of the captive will be lower than that of the traditional insurance market.

All the CRI captives that came after Raffles have adopted virtually the same mission—a key to their longevity.

CICR: Are your captives heterogeneous or homogeneous?

CRI: CRI offers prospective captive members both heterogeneous and homogeneous captive options. Both of these operate essentially the same way, i.e., similar unbundled structure, same risk-funding formula. When a prospective member must decide which type best fits its business, CRI will advise the potential advantages and disadvantages of each, and endeavor to provide the information the prospect needs to make a sound decision.

CICR: And, what types of coverages are available?

CRI: Most CRI captives write workers compensation, general liability, and automobile insurance. While member-owners revisit this issue periodically, they typically opt to stick to the original vision of providing basic commercial coverages and not to stray into difficult or specialized lines of coverage which are less predictable and could potentially produce negative results for the captive. In addition, the underwriting committees of the captives continually review types of businesses to target to ensure the desired risk profile for the captive. Members know their captive is sound and will continue to be so by maintaining this focus.

CICR comment: This conservative business model sure differs from many captive models, where the captive strays into other risky lines, often not fully appreciating the much higher risks. Though sometimes this is necessary, we wonder how often this is done because of poor or nonexistent advice from brokers and managers, or just plain foolishness by the captive owners themselves.

CICR: What type of rating formulas does CRI use for its captives?

CRI: Widely known as the “A Fund/B Fund” formula, CRI initially worked with captive members on the development of the captive funding formula in the early 1980s. It remains the basis of all CRI captives, and its core has become an industry standard for group captives. The A Fund provides for frequency losses; the B fund, for severity losses, and there is a provision for assessment should a member’s experience exceed “expected.” In addition, there is reinsurance protection for catastrophic losses exceeding the captive retention, and aggregate excess coverage to further protect the captive. “Basket” and “clash” coverage is also typically provided. Members accrue interest income on unused loss funds and through good loss control, which creates significant opportunities to have those funds returned in the form of dividends.

CRI captive members are successful, savvy business owners. Though experts in their respective arenas, they are not insurance industry practitioners and, as such, should not be expected to have in-depth understanding of the intricacies of insurance. However, assuming the role of insurance company owner and having responsibility to make the decisions to run the company demands a higher level of insurance acumen. The simplicity of this risk funding formula helps CRI captive members understand how insurance works and ensures that their costs are truly reflective of the risk they pose. Members know exactly what their costs are, the exact components of those costs, and their dividend potential, and have indicated a clear preference for this transparency.

CICR comment: This simplicity is the key.

Further, the captive members understand and are committed to the objectives of the risk funding formula that are fair and equitable, incorporate appropriate risk sharing among the membership (for shock losses), and incorporate adequate funding through assessments for greater than expected loss experience. The for-

mula fulfills the major objectives of providing adequate funding and protection for the captive and cost control for the member.

CICR: I understand that you rely on tailored loss prevention/claims management programs. Please elaborate.

CRI: Superior loss prevention and claims management programs are the cornerstone of CRI captives. Controlling losses is a responsibility of membership, and it is through effective prevention and management of losses that captive members can continually control their insurance costs. CRI works with each of its captives to develop programs and metrics tailored to the unique needs of the membership. CRI develops, supports, measures, and assists in remediation of member risk control programs, and seeks feedback from members to ensure that programs are meeting member needs/expectations. Examples include semiannual risk control workshops, regularly scheduled claim reviews, and the development of an in-depth risk assessment methodology.

Most support services are provided on an unbundled basis, coordinated by CRI, which is accountable and reports directly to the captive board. CRI has built relationships with a wide array of captive service providers including policy issuance companies, reinsurers, claims administrators, loss prevention consultants, actuaries, banks, and audit firms. While the sheer volume of business may provide a certain degree of leverage, it is the strong, mutually beneficial working relationships that have been built over 25+ years that result in not only highly competitive cost structures for the captives, but in a true commitment to work in partnership with CRI and its captives. CRI assists the captives in selecting and overseeing service providers in all functional areas and advocates an unbundled approach to servicing its captives mainly because of the flexibility it provides.

CICR: CRI expects that group captive members be active participants in their captives. Can you describe those responsibilities?

CRI: In addition to paying premiums and posting collateral, CRI group captive members have specific responsibilities to the captive and to their fellow members. These responsibilities are clearly defined and communicated to every prospective member as part of the initial educational process, and include controlling losses in accordance with the captive's established risk management standards (to control both their own and the captive's costs), attending and participating in board and committee meetings to assist in running the captive, and referring other quality companies for membership. Members understand these responsibilities and the rationale behind/potential benefits of each. They recognize that fulfilling their responsibilities only serves to strengthen their own businesses and their captive and generate positive results for both.

CRI captive members know that their fellow members are among the best companies in their respective industries and that they have been carefully vetted in the initial recruitment and subsequent underwriting process. In addition, members' financial positions are reviewed each year by the captive's independent financial analyst to ensure that they meet the captive's minimum requirements. Members have the peace of mind that comes from knowing that the other members of the captive are financially strong and stable, have management with a shared commitment to safety/loss prevention and proactive claims management, and have average or better than average loss history. (It's important to note that all individual member data, including loss information, is kept strictly confidential and is always presented to the captive in a blind fashion. Members' financial information is seen only by the captive's independent financial analyst and is not shared with the membership.)

CICR comment: Can group captives overseen by many major brokers or insurers say the same?

Unlike the traditional market, which often marries its support services (claims and loss prevention) to coverage, the captive can

change any of its services at any time with minimal or no disruption or additional cost. This is an ideal structure for a middle-market company, which does not typically have the resources to dedicate to running a captive.

CRI selects outside service providers according to a captive's specific needs and then serves as the day-to-day liaison with each service provider and provides general oversight. A dedicated support team is assigned to each captive and is available to each individual captive member. The support team for each captive consists of an account executive, program manager, claims manager, loss control/safety professional, financial adviser, and a meeting planning specialist. Each captive member has access to every team member for any reason, at any time. This high level of responsiveness and personalized attention not only ensures that the captive operates smoothly, but fosters member appreciation and commitment to the captive, and further distinguishes the CRI model from others and from the traditional market.

CICR: What role do agents and brokers play?

CRI: CRI's solid relationship with its many agents and brokers throughout the country is a critical factor in the continued growth of its captives. CRI currently works with over 200 brokerage offices nationwide, including the nation's largest brokers, and its account executives work to establish, cultivate, and maintain collaborative relationships with all of them. Agents/brokers are educated and trained in the captive's process. They must be committed to working in close cooperation not only with CRI, but with other captive service providers, such as loss prevention consultants, TPAs, etc. The broker, in essence, becomes an integral part of the support structure of the captive.

CICR comment: However, these agents and brokers do not have a financial stake in the captives or in CRI. They earn commissions as with the commercial market.

Brokers present a continual flow of qualified companies for membership consideration

because of the upside potential not only for their clients, but for their own businesses. Aside from the positive long-term benefits for their clients, some key aspects of CRI's approach that brokers find attractive are:

- ✓ CRI does not pose a competitive threat to its brokers since its only business is captive consulting.
- ✓ CRI has committed extensive resources to educational programs for brokers and their prospects.
- ✓ Access to CRI captives provides brokers with the ability to bring a viable captive option to their middle-market clients without significant financial investment; brokers can expand their service offering and differentiate themselves from competitors with a turnkey solution.
- ✓ Brokers maintain control of their relationships with their [captive] clients—placing a client in a well-managed, successful captive often moves the broker to “trusted adviser” status.
- ✓ CRI's high captive member retention offers brokers opportunities for long-term revenue stability; it also can translate to less time and money dedicated to renewal business.
- ✓ Captive members often refer companies they know and work with (e.g., vendors, suppliers, customers) to their broker for membership consideration, offering opportunity for business expansion and increased revenue.
- ✓ The ongoing daily support that CRI provides can contribute to broker profitability since CRI captive business requires less time/effort to service, as compared to traditional market accounts.

CICR: At the outset, you mentioned the value added services CRI provides. What does this mean to you, and can you provide some examples?

CRI: At CRI, the now prosaic label “value added” is not perceived as an accounting, economic, or even a marketing concept. Continuous improvement is a core principle of the company's business philosophy and, as such, ongoing

efforts to improve services or processes flow through and support the other components of the business model. A number of features and programs have been developed and, together with some less tangible items, have greatly contributed to a sustainable competitive advantage for both the company and its captives. These “value added” initiatives may reduce costs, improve efficiency, or maximize organizational effectiveness, but ultimately all are designed to positively enhance members' experience in a CRI captive. The following are some concrete examples.

- ✓ The Captive Investors Fund (CIF) is a Cayman Islands Mutual Fund, that is a proprietary investment vehicle established by CRI in 1994 for the purpose of providing its captives with an investment option that allows each captive to improve its investment yield while balancing portfolio risk, credit quality, and liquidity. With a total net asset value of approximately \$1.5 billion (at 7/31/11), the attention and respect that it commands in the investment world significantly enhances the investment capabilities of CRI's captives.
- ✓ Kensington Management Group, Ltd., is CRI's offshore captive management sister company. It specializes in group captives and is better able to accurately produce the complex financial/equity statements group captives require.
- ✓ Commutation negotian/tail fund development.
- ✓ A group purchasing program providing members discounted pricing on loss control/prevention products and services.
- ✓ Access to Everest Property Insurance Company, a nonassessable captive for property coverage available only to CRI captive members.

CICR comment: Many group captives only do some of these. Also, many of those group captives use prearranged service models with minimal tailoring to the actual needs of the particular captive. The CRI model is quite comprehensive in the scope of services, many of which can be divorced from CRI. ■