
Business Insurance

Middle market companies show interest in captive insurance

More midsize companies showing interest in alternative risk financing

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Interest in captive insurer arrangements among middle-market insurance buyers is booming as the traditional insurance market hardens for certain lines of casualty coverage, captive experts say.

While middle-market insurance buyers typically have been drawn to group captive arrangements that enable them to pool their risks with other like-minded companies, a growing number are exploring rent-a-captives, protected cells as well as microcaptives that are formed under Section 831(b) of the Internal Revenue Code.

In addition, many midsize companies considering self-funding in response to the federal health care reform law are looking at group captives to help

fund medical stop-loss coverage as a hedge against potentially catastrophic claims, captive experts say (see related story).

“There is significantly more interest in captives this year than last year,” said Art Koritzinsky, managing director of Marsh Inc.'s Captive Solutions Group in Norwalk, Conn. Increasing premiums are being funneled into group captives as well as new formations by smaller, middle-market companies, he said. “The insurance markets are hardening, and a lot of companies have been through what happened in the hard market 10 years ago and are preparing.”

“We're definitely seeing an increase in the use of group captives, rent-a-captives and microcaptives by middle-market companies,” said Chad Kunkel, division senior vp and group captive strategy leader at Artex Risk Solutions Inc., the captive management unit of Arthur J. Gallagher & Co. in Itasca, Ill. “I'd say we've seen a 100% increase in new business to existing captives over last year.”

Mr. Kunkel said the last time he saw this big a surge in captive use by middle-market companies was in 2003, the start of the last hard market. Unlike that year, when new group captives had to be formed to accommodate that business, many middle-market clients coming to Artex today are joining existing group captives, he said.

Multiple captives

In some cases, companies are using more than one alternative risk transfer vehicle, funding their workers compensation exposure in a group captive or a rent-a-captive and then placing other risks, such as warranty risk, pollution risk or directors' and officers' liability risk, in a microcaptive, he said.

In fact, the bulk of new captive formations by Artex involve microcaptives, the small, single-owner captives whose annual premiums are limited to \$1.2 million under the IRS code. "We did 60 new microcaptives last year and we're looking to do the same again this year," Mr. Kunkel said.

Doug O'Brien, national casualty and alternative risk practice leader at Wells Fargo Insurance Services USA Inc. in New York, said his firm has formed about 15 new group captives this year mainly "driven by workers compensation issues" in California, Florida and the Gulf states.

In addition, "we're seeing a lot of interest in 831(b) captives for risks that have low frequency and moderately high severity like product warranty, product recall, loss of key customer, loss of key supplier, insurer bad faith, and to fund some property deductibles," Mr. O'Brien said.

Steve Paulin, senior vp at Irvine, Calif.-based broker SullivanCurtisMonroe Insurance Services L.L.C., said many California-based middle-market clients are turning to captives in response to the hardening workers comp rates in that state. "We've seen businesses get 65% to 80% rate increases, and it will probably repeat itself next year," he said.

While many businesses hit with major workers comp premium hikes are considering loss-sensitive, large-deductible plans as an alternative to higher-priced guaranteed-cost coverage, Mr. Paulin said he is introducing some privately held middle-market companies with good loss experience to the captive insurance concept.

"Before 2004, the only option most middle-market companies had to guaranteed-cost workers compensation was large deductibles. Some went well, some didn't," he said. "Then, about two and a half years ago, I was introduced to the 831(b) concept, which fascinated me. I saw opportunities to use it for workers comp, perhaps providing a middle layer of coverage. Six to nine months later, I saw that captive managers were becoming more assertive and aggressive with their marketing" to middle-market companies.

Learning curve

While interest in captive solutions among middle-market buyers is definitely greater than recent years, "it's more a push than a pull," Mr. Paulin said. "Most businesses have heard of captives, but they need to be educated. So we have been taking select clients and prospects and enrolling them in webinars." Aside from microcaptives, "we have been touting the group captive concept primarily in the traditional areas: work comp, general liability and auto liability."

George Rusu, co-founder, chairman and CEO of Schaumburg, Ill.-based Captive Resources L.L.C., said group captives the consultant established on behalf of middle-market clients have reached combined premium volume exceeding \$1 billion, with more than \$220 million of the new premium added in the past 24 months.

Mr. Rusu attributed part of this growth to some improvement in economic conditions.

“If you look at the (profit and loss statement) of a midsize manufacturer, the third or fourth item is insurance, and that's one cost they can never really control,” he said. “Captives enable them to control and predict these costs. People who have been in our captives for a while understand the loss model and can almost tell to the dollar what their costs will be in a year or two.”

In some cases, these captive members even lower their costs because the programs emphasize loss control, Mr. Rusu added.

“When you go into a group captive, you're joining a club. You're not just buying insurance coverage. You should be very focused on claims and loss control and willing to participate,” said Les Boughner, executive vp and managing director of the global captive practice at Willis Group Holdings P.L.C. in Burlington, Vt.

As such, “a lot of middle-market companies that look at group captives see it as a way to get more competitive insurance. They have confidence that their claims experience will remain good or get better,” Mr. Boughner said.

“If a client has been buying guaranteed-cost coverage and their loss experience is such that they really haven't had a lot of adverse loss experience, that's the first candidate that should look at a group captive,” said Lisa Wall, senior vp and director of risk finance at Lockton Cos. L.L.C. in Kansas City, Mo. “They want to see another option.”
