A group or association captive is a structure in which multiple businesses join forces to create an insurance company that collectively covers liability and risks.

According to Duke Niedringhaus, vice president of JW Terrill, the genesis of the group captive industry was the Raffles Insurance captive, with most group captive structures formed post Raffles using the same successful model.

Based in the Cayman Islands, Raffles was formed by nine companies in 1984 to enable businesses to acquire adequate coverage at affordable rates. The famous group captive has now grown to over 300 members.

A statement from the Raffles Insurance website claims that "by bonding together to create true sharing of risk, shareholders can control their insurance costs rather than being subject to the volatility of the general insurance industry."

Michael Gibbs, president of the Kensington Management Group, explains that group captives were initially linked to specific industry associations and that in the mid-1980s the first groupings of unrelated and diverse industries were formed.

"The founders of these groups wanted to offer the benefits of a captive to smaller middle-market well run companies, on the basis that bringing together a number of companies in diverse industries and in diverse geographical areas, would achieve a diversity of risk profile similar to that of a traditional insurance company, and the buying power of a Fortune 500 company."

Gibbs explains that a 'traditional' group captive comprises of unrelated companies, whether in common or diverse industries that are financially sound and prepared to shares some risk with their fellow captive shareholders.

"While single parent captives will have the same high standard of risk control and safety culture, there is no risk sharing in that structure. Additionally, group captives will normally be looking for new like-focussed 'members' to join, so as to increase buying power and minimise the impact of risk sharing."
Fitting the bill

As with any alternative risk vehicle, group captives aren’t suitable for every company looking to insure its own risks for various reasons, be it size, lines of cover or capital.

JJ Purdy, president of Garnet Captive Services, explains that the structure is aimed at companies that are sophisticated enough to know they need to assume risk in order to control the long-term cost of insurance but are not large enough to either withstand the volatility of traditional forms of risk, or to garner enough interest for a quote from a traditional insurer.

Gibbs feels that any well-run company with an established and effective safety culture and a favourable loss history would be good candidates to start or join a group captive structure.

“As regards lines of coverage, regular casualty lines of workers compensation, auto, auto physical damage, and general liability are the most common [for group captives], but property and medical insurance stop loss are also becoming popular.”

Purdy believes that many different coverages can be fit for a group captive structure. But that the attributes that typically make the structure work are exposures that have a component of controllability and predictability.

In terms of actual requirements, Niedringhaus explains that they are fairly minimal. “There is a small capitalisation of about $35,000 plus collateral (cash or letter of credit) to secure the potential risks of the participating member of the captive.”

While coverage lines and requirements are important factors, according to Niedringhaus, one of the mains reasons and great advantages of group captives is the minimum casualty premium of only $150,000—making the captive alternative that large corporations relish available for many mid-size companies.

And if a company is suited to the group captive route by meeting the above requirements, the final hurdle is to decide whether a heterogeneous or a homogenous captive is more preferable.

Gibbs says that an “industry specific or ‘homogenous’ captive will comprise member companies drawn from one industry with a similar risk profile, eg, trucking, or construction. Heterogeneous captives are those with member companies drawn from a blend of diverse, unrelated companies within certain risk parameters.”

According to Purdy, Garnet Captive Services has experience with both heterogeneous and homogeneous groups, witnessing positives and negatives in both types.

He says: “A homogeneous group can provide consistency in exposure, which can help in underwriting and pricing. It can also allow for specialisation and leverage to loss mitigation efforts.”

“However this homogeneity can also subject the entire group to the risk of failure due to an institutional risk; an occurrence or trend that affects all companies across that specific industry (whether it be insurance related or simply economic).”

Niedringhaus states that homogeneous captives can certainly tailor their loss control programmes to specific member exposures and provide industry specific networking. However, he feels that the group captive industry has proven that diverse companies utilising a heterogeneous captive can achieve success.

“Targeting different industries to grow a captive can generate substantial growth and thus reduced fixed costs and spread of risk for severity losses. Several of the premier group captive facilities are heterogeneous.”

Reaping the rewards

Purdy explains that for well run companies it is far more cost effective in the long run to assume risk rather than transfer it in a traditional marketplace.

“The main benefit of a group captive is that it enables its members to assume risk where that risk assumption otherwise would have been intolerable or unavailable.”

Another added benefit that Purdy highlights is the ability in most structures for the unbundling of service providers. “Where in most traditional insurance transactions the insurance company controls and dictates service, many group captives provide the ability to choose the highest quality claims, loss control, and other vendors, many of which can lead to even lower ultimate costs of insurance.”

According to Niedringhaus, the main benefit of joining or forming a group captive is the control that a member obtains over its insurance programme.

The benefits of group member control include, cost savings due to a well-run captive, claims management, and the opportunity to receive all underwriting profits and investment income, which can then be deferred to a family trust.

Niedringhaus adds that group captive members also greatly benefit from regular active communication between members.

He says: “The group captive model requires active engagement by the members including two board meetings and two risk control workshops. If there is one reason for success of the group captives, it would be active member engagement. Members all join a committee to manage the captive such as underwriting, risk control or investments. Members are active in recruiting new captive members to fuel growth and thus reduce fixed costs.”

Embracing the pitfalls

As with any risk management option, there will always be flaws to the structure. Purdy points the potential downsides, narrowing them down to, the size of the group and the potential insurance risk/credit risk from other members of the group.

With regards to group size, Purdy explains that since the group risk sharing component of the structure provides a “shock absorber” of sorts for volatility to any one member, it is important that the group is of sufficient size.

And while a group is at risk if it is too small, there are also potential pitfalls to structures that are too large. As Purdy explains, its not just Goldilocks that requires things to be ‘just right’.

“The ideal size is one that is large enough to withstand the volatility that comes with large claims, but small enough such that all members can sit in a room together and make decisions about their programme.”

The issue of credit, according to Purdy, should be a simple task of delegation between members. He says that each member should be responsible for a distinct, limited amount of exposure.

“It is important that the programme manager structure the group such that every member is providing security to the group that ensures their ability/willingness to meet their responsibilities, even in the worst case scenario.”

Niedringhaus explains that the group captive industry continually faces the challenge of obtaining final closure on an underwriting year, which poses a time consuming problem for all members involved.

“Workers compensation and liability are fairly long tail exposures and adverse losses can generate assessments that continue for several years … Some managers have developed solutions for closing an underwriting year but there are limited options for a loss portfolio transfer when products liability is written in the captive. We have brokered the transfer of the open liabilities for one large complex captive and found the process to be a very arduous nine month process.”

But despite some unappealing downsides, Niedringhaus claims that companies rarely return to the traditional insurance market after using a group captive.

“Group captives have seen amazing growth recently through various market conditions. We estimate it is a $1.5 billion market in the US and 70 percent of that premium has been added in the last decade. [Last year] added about $200 million in premium and the first quarter of 2013 has already added $75-$100 million.”

“Once engaged in the group captive for workers compensation, auto and liability exposures, business owners are looking to expand their captive use to other health insurance group captives and 831(b) micro captives for their uninsured business risks.”

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