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Captive Insurance Company Reports

Affinity Programs and Captives

Editor's Note: The following was written by **Michael Turk** of Towers Perrin in Stamford, CT. He may be reached at michael.f.turk@towersperrin.com or at (203) 351–5193.

Captive owners have been told for years that there may be opportunities to write affinity programs of its sponsor into the captive. Though few have been done, *CICR* thought a more expansive discussion was timely.

At a recent Vermont Captive Insurance Association (VCIA) presentation by **Robert Flannery,** Manager of Captive Operations for Verizon Communications, he described how Verizon's captive, Exchange Indemnity Company, is used to reinsure personal lines coverages offered to employees. Verizon Communications offers employees the opportunity to purchase their own personal auto/homeowners insurance from MetLife, Liberty Mutual, or Travelers Insurance. Employees can purchase these coverages at a discount from the normal retail rates charged by these three insurance companies. In addition, Verizon employees can have the convenience of having their premiums deducted from their paychecks. Mr. Flannery indicated that Exchange Indemnity reinsures between 30–35 percent with these insurers. He also said that Exchange Indemnity was not trying to profit from the program.

Wayne Tryon, Affinity Group Sales Director for Travelers Insurance, told *CICR* that Travelers has several quota-share reinsurance deals in place with captives and was seeking more opportunities to write personal lines employer-sponsored insurance programs with the support of the employer's captive.

Affinity Insurance Programs

Affinity programs are typically offered to group members, e.g., teacher, associations, travel and auto clubs, bank customers, etc. The largest program is most likely the AARP-sponsored coverage underwritten by Hartford. For this article, we are going to focus our comments on employer-sponsored insurance programs.

Also in this issue

Few Captive Deals Despite Interest

Although there has been interest by many corporate captives in reinsuring the personal lines insurance programs offered by their parent, very few captives have actually stepped up to reinsure the programs (we estimate only a half-dozen or less). Many of the employer-sponsored programs reinsured by a captive have been placed by **Mark Cohon** of American Benefits Consulting LLC. Five of his 45 employer-sponsored programs use captives to reinsure the personal lines exposures. Insurers, however, reported supporting over 5,000 such programs.

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The lack of participation by captives in these programs is not because insurers are unwilling to have the captives participate. Captive insurance company reluctance may reflect a concern about the risk (especially for employers with employee concentrations in coastal areas) to which these programs could expose their captives. Typically, an insurer will expect the captive to assume risk on all coverages written by the employer's program—the captive can't pick and choose the risks.

We also understand that some risk managers are waiting for the employer-sponsored program to reach a minimum premium size before beginning to reinsure the program. **Lois Fuchs,** Assistant Treasurer—Risk Management of Honeywell International, said it offers personal lines coverages to employees. Honeywell initially decided not to reinsure the program because the premiums had been so small. The program has grown, however, and it plans to consider a possible reinsurance program again. This may be a smart approach for another reason: loss proformas for these programs generally reflect greater risk in the first 2 years than in later years.

Captives may also be concerned about privacy or employee perception issues associated with reinsuring these programs. **Paul Van den Bergh,** Senior Vice President with Marsh Global Consumer, indicated that some employers will no longer release employee names and addresses for direct mail communications. These employers rely on e-mail, desk drops, and other internal communication channels. These methods, however, are not as effective as direct mail marketing.

Another potential difficulty is internal politics. Captive insurers are typically managed by Treasury or Finance, while decisions to offer new employee benefit programs rest with Human Resources.

Tim Bruns, President and CEO of Merastar Insurance Company (now part of Unitrin Direct), said Merastar has over 150 employer-sponsored insurance programs. It has worked closely with about a dozen captives to put together reinsurance programs. In each case, however, the captive ultimately decided not to participate in the program. The Walt Disney Company is Merastar's largest client, and it also decided against using its captive on the program. Interestingly, **Tim East,** the Director of Risk Management for The Walt Disney Company, was on the same panel with Mr. Flannery of Verizon Communications. Mr. East noted during the session that The Walt Disney Company uses the Humana model for achieving premium tax deductibility. Third-party business or profits are not a driver for its captives. He described how the firm considered writing travel insurance but decided against it because it did not want the perception of profiting on this coverage.

Alcoa's Experience

Alcoa also offers these coverages to its employees and uses its captive for reinsurance. **John Wilson,** President of Three Rivers Insurance Co. (Alcoa's captive), said this has been profitable business for Three Rivers. Alcoa had a product with one insurer that was not actively marketed and had low participation rates with its employees. About 2 years ago, it rolled out a new program with MetLife, Liberty Mutual, and Travelers. The insurers conduct joint marketing efforts, and employee participation has increased. Mr. Wilson said the program was a nice collaboration between the Human Resources and Risk Management Departments, with both units adding value to the corporation in their respective areas of responsibility. During a time when there is increasing pressure to reduce the cost of employee benefits, Human Resources was able to launch a new program, at almost no additional cost, that may reduce an employee's personal insurance premiums and enhance coverage. He also said the program was easy to administer.

Three Rivers liked the product offering because it is profitable business (Three Rivers is a profit center), the risk provided diversification of its traditional lines, and the third-party business is generally considered unrelated for tax purposes. Three Rivers also writes other employee benefit coverages. In addition, it assumes third-party business from property and casualty pools and "straight-up" traditional treaty property and casualty reinsurance. Although this type of business has a bad reputation with captives as a result of some poor results in the 1970s and 1980s, Mr. Wilson said that they have learned how to manage this unique business segment. He added that the unrelated third-party business has been profitable for Three Rivers in each of the last 6 years.

Reinsurance Benefits for Captives

The benefits to a captive providing reinsurance to these programs could be substantial. Like the employee benefit coverage being underwritten by a few captives, reinsuring the employee auto and homeowners coverages may be an attractive source of third-party business for the captive. The coverage may also represent a source of profits. **Christopher Capone,** AVP and Senior Managing Director with the Auto/Home Voluntary Benefits group of Liberty Mutual, said that he believes the four captives his organization works with have each produced profitable results in the aggregate over the period they have participated in the programs.

"We believe that more organizations will begin to use their captives to reinsure these programs," he said.

Liberty Mutual has 4,500 employer-sponsored programs. Although many of these are probably for small employers, the popularity of these programs appears to be growing. Mr. Capone said Liberty Mutual is currently working with three captives regarding potential employer-sponsored insurance programs.

MetLife said it has almost 2,000 employer-sponsored and affinity programs; Travelers has close to 700 employer programs—most of which are agent-managed "small group" programs. In excess of 100 of these programs are centrally managed. Merastar reported over 150 employer programs. Differences in the sizes of employer-sponsored programs between the different insurers are due in part to different requirements to offer these programs.

Other Benefits

Beyond the captive benefits described above, these programs provide the employer with an additional value-added benefit to offer its employees and potentially increase employee retention. Best of all, these programs don't cost the employer anything.

As previously noted, these programs typically offer the employee a reduction in the retail premiums that the insurance company charges. Additional coverage enhancements or special discounts may also be provided in some cases (for example, an employee tenure discount if the employee has been working for the employer a specific number of years). The convenience of payroll deduction is attractive to many employees and may also include a premium discount. In addition, the employer may be able to provide assistance to the employee to help in resolving any issues with the insurance company. The employer's leverage with the insurer will probably depend on the volume of business and profitability of the employee business with the insurer. In some cases, the employee can maintain the personal relationship and services from a retail agent and still qualify for the employer's program discount, payroll deduction, and other benefits.

Typical Product Offering

The insurance policies offered to employees typically include the normal personal lines coverages of auto, homeowners, umbrella liability, and recreational (e.g., boats, motorcycles, etc.). The insurers offer a discount off their retail insurance rates (this will vary by state but usually ranges from 5–10 percent), or they may have a separate rate filing for affinity and/or employer-sponsored insurance programs.

Employers may offer their employees insurance coverage from one insurer or coverage from up to three different insurance companies. Multiple insurers will probably increase the employer's penetration rate for the program, because one of the insurers is more likely to offer a competitive premium and meet the employee's insurance needs. The ability to offer more than one insurance company will require a larger employee base to provide sufficient volume for each insurer. Marketing of the program must be closely coordinated between the employer and each insurer participating.

If multiple insurers are available to employees, the employer usually provides a single toll-free number to call to obtain a quotation. The employees then select the insurer they want to quote their policies. If three insurers are participating, however, this may require three separate phone calls. In addition, the employee will need to provide underwriting information to each insurer separately. This can be a time-consuming process. **Mark Cohon** of American Benefits Consulting said, however, that this has not been an issue with his clients. He said that the insurers' call centers do a very good job of collecting the underwriting information and providing the quotation. In addition, his firm is working on a Web site where the employee only has to enter the underwriting information once.

Marsh Global Consumer has an alternative to employees making multiple phone calls to obtain quotations. It has call centers in Iowa, Michigan, and Massachusetts that can receive the employee's phone call. The call centers collect information from the employee once and can then provide multiple insurer quotes. They currently have online quoting capability for auto insurance, but must access each insurer's system separately to obtain home insurance quotes. The call center consultant provides the employee with the lowest auto insurance quote and will also provide counsel on coverage differences where they exist. For the homeowners quote, they will first go to the insurer who provided the lowest auto quote (to obtain multi-policy discounts). If that quote is not competitive, they will quote other insurers to seek the best package premium.

The auto quote from Marsh Global Consumer usually takes between 10 and 15 minutes to complete. This is obviously less time than it would take an employee to call three different insurers, repeatedly provide underwriting information, and obtain quotes. In addition, the employer will gain administrative efficiencies by not having to maintain multiple interfaces with each insurer in their program. However, in many situations, this service will add an additional cost to the program.

Marsh Global Consumer has over 100 auto and home programs for corporate and institutional clients. Although it has reviewed several possible captive opportunities, its current employer programs don't utilize captives.

Participation Rates

Mr. Cohon said that *employee participation rates are significantly higher in his brokered programs when captives are used to reinsure the program.* He estimated the average participation rate to be 19 percent in programs without captive involvement and 32 percent when the employer's captive is used to reinsure the program. He believes the higher participation has two explanations. First, the partnership formed between the Risk Management and Human Resources Departments results in greater support for the program. This has sometimes also lead to expanded discussions regarding the use of the captive for life and disability benefits. Second, four of the five captive programs that he brokers offer multiple insurance companies to their employees. Offering more than one insurance company raises participation rates astronomically, according to Mr. Cohon (41 of his 45 employer programs offer multiple insurers).

To highlight the benefits of multiple insurer employee offerings, Mr. Cohon gave the example of Amgen Inc., a client with 11,000 employees. Eighteen months ago, it rolled out a program to employees offering insurance from Liberty Mutual, Merastar, and Travelers. Amgen already has 1,700 employees participating in the program (15 percent participation after only 18 months). Amgen has a captive and is currently evaluating its participation in the program. He said Amgen is looking for the program to reach a larger premium size before participating.

Insurer Requirements from Employers

Insurance company requirements to offer employer-sponsored personal lines coverage to their employees vary by company, but generally include the following.

Number of Employees. Liberty Mutual appears to have the lowest requirement for the number of employees (50, and only 100 employees for payroll deduction). MetLife and Merastar both require a minimum of 500 employees to offer the program. MetLife requires 1,000 employees for payroll deduction. Travelers requires 2,500 employees to be part of its centrally managed employer-sponsored program, but can go down to 100 employees in its "small group" programs that are managed by local agents.

The minimum number of employees required for a captive to participate in the program will be substantially higher. Although there are no hard-and-fast rules in this regard, one insurer suggested that something in excess of 20,000 employees may be necessary. In excess of 100,000 employees may be necessary to offer a program with three insurers that utilized an employer's captive.

Payroll Deduction. Insurers prefer payroll deduction for collecting the premiums. Not only does this simplify the premium collection process, but insured retention rates are higher among those who pay through payroll deduction. This does require some systems compatibility between the employer and the insurer. If multiple insurers are being used, the employer may need to maintain separate interfaces for payroll deduction with each insurer. Mr. Van den Bergh of Marsh Global Consumer noted that its clients only need to maintain one interface with them, regardless of the number of insurers the employer offers.

Marketing of the Program. Insurers want employers to promote the insurance program to their employees. This may include two direct mail campaigns to the employees' homes per year, onsite learning sessions, employee benefit fairs, and payroll inserts.

Time Commitment. A 3–5-year commitment is often sought from employers. These programs typically go through a ramp-up period. Mr. Capone said that a successful program could reach 10 percent participation after 1 year and 35 percent after 5 years.

Captive Participation. Insurers will review the captive for capital adequacy to support the percentage of the program to be reinsured by the captive. Unless the captive is rated, a letter of credit or other collateral is likely to be required. Collateral requirements are usually reviewed annually. The captive reinsurance is usually done on a quota-share basis with a maximum ceded amount of 30–50 percent. Expenses and ceding commissions will need to be negotiated.

An Opportunity for a Captive?

Each employer will need to evaluate whether it believes reinsuring its sponsored auto and homeowner employee business is desirable. A small group has already decided that the third-party business or potential profits from these programs are attractive. Towers Perrin believes this group will grow. Others, however, may decide that their program is too small, the potential for profits is not sufficient, the risks are too large, or that employee perception or privacy issues are too great a concern.

CICR comment: The willingness and ability to write these employee benefits into a captive is fraught with the same internal political problems that plague risk managers and their Human Resource brethren when writing any benefit program. We recommend rereading the many *CICR* articles written since 2005 by Towers Perrin on insuring employee benefit programs in captives. Several discuss how to handle the sensitive interaction between the Human Resource and Risk Management Departments. ■

Advantage of Reciprocals for Nonprofits

Editor's Note: **Nitin Chhabra** of the Tillinghast business of Towers Perrin in Washington, DC, covered this session at the recent Captive Insurance Council of the District of Columbia conference.

William Boone, Senior Vice President, Marsh, Inc., and **Richard Seligman,** General Council, Caring Communities, discussed nonprofit reciprocals as well as Caring Communities' success story converting to a reciprocal risk retention group (RRG) domiciled in the District of Columbia (DC).

Mr. Boone began with an overview of RRGs, after which he discussed the needs and characteristics driving the choice of alternative risk financing vehicles for nonprofit entities. The "historic" solution is for nonprofit enterprises to form offshore captives while the "classic" solution is for nonprofit enterprises to form American-domiciled RRGs and be reinsured by an offshore captive.

A primary requirement for a nonprofit entity is to maintain its nonprofit status, which is usually defined by Section 501(c)(3) of the Internal Revenue Code. Nonprofits enjoy tax-free benefits, and maintaining this status allows them not to be treated as a taxable insurance entity. (See *CICR* April 2001 for a complete review of tax issues for tax-exempt captive owners.)

The "historic" solution is for nonprofit enterprises to establish offshore captives. This has been occurring since the 1970s, with the Cayman Islands and Bermuda being the most popular domiciles. Most of the time, these offshore captives were nothing more than risk-funding vehicles; they would retain zero insurance risk. Premiums were actuarially determined on a frequent basis, and revisited at the end of the year to be equivalent to the sum of losses and expenses. Because they retain zero insurance risk, they would fail the Internal Revenue Service (IRS) test for insurance company recognition, which is the preferable tax treatment for tax-exempt owners.

A problem with an offshore captive is that when insuring physicians or related entities, they typically do not want to do insurance business in the state of the risk's location to avoid running afoul with state insurance regulations against non-admitted insurers. This makes the insurance process much more difficult, because no insurance work can be done onshore.

Now for the "classic" solution: creating an RRG and having the RRG reinsured by an offshore captive. The RRG would retain primary losses and then cede most of the loss to the offshore captive. This effectively makes the RRG a pass-through. Under this structure, the offshore captive would retain the profits rather than the RRG. This allows the RRG to enjoy the tax-free benefits of a nonprofit entity; however, the disadvantage of this solution is the creation of "double" administrative work due to the existence of two entities in two domiciles.

This is where the recently accepted reciprocal RRG, as allowed by the District of Columbia, is advantageous. Although reciprocals have existed for over a century, they have not been merged with the RRG format until recently. Compared to fronted captives, reciprocal RRGs cost less (i.e., it eliminates the need for fronting and also eliminates the fronting insurer's collateral demands), require less administrative work, and provide more flexibility (i.e., easy to expand within the state, more policy form flexibility, and insureds can be either individuals or institutions). Compared to RRGs reinsured by offshore captives, reciprocal RRGs have the advantage of only requiring one insurance entity, thus allowing all business to be done onshore. Also, much of the administrative costs are reduced by only requiring one set of actuaries and auditors. Finally, reciprocal RRGs provide tax efficiency and effectiveness by taking on the tax characteristics of each subscriber.

There remain some disadvantages, however. Compared to fronted captives, there will be state premium taxes, a small domicile premium tax, and required capital, which is now determined by the RRG domicile. Also, there will be a greater attention to governance and separation issues, and capital needs to be structured carefully.

In respect to reinsuring to offshore captives, it too requires greater attention to governance and separation issues and careful capital structuring. Also, subscriber savings accounts must be paid out upon leaving the RRG, though this can be structured over time.

An example of a nonprofit group that has successfully converted to a reciprocal RRG is the Caring Communities organization. Prior to conversion, Caring Communities, which is a Maryland-based nonprofit organization that provides disability-related services to thousands of people in the Washington area, had a domestic (DC) RRG reinsured by a Cayman Islands captive. For reasons that included enhancing their ability to market, reducing their potential for regulatory issues, and facilitating insurance policy administration, Caring Communities decided to covert to a reciprocal RRG. In this process, the domestic RRG redeemed its common shares. At the same time, shareholders of the Cayman Islands captive exchanged their shares for subscriber capital accounts of the reciprocal. The result is that the captive insurance company became a subsidiary and a reinsurer of the domestic RRG, and the domestic RRG became the direct issuing insurer. ■

Cayman Captive Forum

Editor's Note: The following was written by **John Lochner** with input from **Tom Hermes,** both of Towers Perrin in Hartford, CT.

The 2007 Cayman Captive Forum attracted over 855 delegates, per **Dan MacLean,** Chairman of the Insurance Managers Association of Cayman (IMAC), which organizes the event. The Forum, the largest financial sector event in Cayman once again, continues to set attendance records, exceeding last year's record draw by 85 delegates. The mix of conference delegates included both current and prospective captive owners. Many were from the healthcare arena, where Cayman continues to leverage its market niche.

Morag Nicol, outgoing Head of Insurance Supervision for the Cayman Islands Monetary Authority, announced her retirement after 9½ years with CIMA to spend more time with her young family and to pursue other interests. **Mary Lou Gallegos,** former Head of Insurance Supervision, who retired just last year, will be coming out of retirement to serve as Interim Head of Insurance Supervision until Ms. Nicol's permanent replacement is named.

Ms. Nicol provided a summary of 2007 year-to-date captive activity in her "State of Cayman's Captive Industry" address. Through November 26, Cayman had licensed 39 new captives, bringing the total number of captives in Cayman to 760. Given pending applications in the pipeline, she estimates Cayman may have issued 45–50 new licenses in 2007.

Cayman's captives write premiums approaching $7.5 billion and have assets of more than $32.6 billion. There are 122 segregated portfolio companies (SPCs) within those captive totals of 760, with the SPCs having 484 cells in total.

Last year, 2007, will prove to be another good year for captive formations for Cayman. However, reflecting the softer insurance market conditions that exist, the 39 new captives formed is down from the 51 formed in 2006 at the comparable time.

Healthcare professional liability and workers compensation coverages remain the predominant exposures insured in Cayman captives, with the substantial majority of Cayman's captives being of U.S. origin (over 90 percent of Cayman's captives are owned by North American parents; U.S.-only figures were not provided).

The conference included the standard educational sessions and tutorials. Several of the sessions were noteworthy and are covered below.

Comments from the Markets

U.S., Bermuda, and London insurer representatives fielded questions from **Val Nichols** of Brown & Brown on a variety of topics. The panelists, mostly with a healthcare focus, included **Dan Curran** of Catlin, **Peter Eastwood** of Lexington, **Marc Hofer** of Swiss Re, and **Ian Thompson** of Endurance Re. Here were some of the more interesting Q&A exchanges:

Will the subprime market have an effect on the insurance industry?

Mr. Eastwood: Yes, but not of a significant magnitude to turn the market.

Mr. Hofer: Yes, but it is likely to affect the directors and officers (D&O) liability market the most.

Mr. Curran: Catastrophes (if and when they occur) will have a greater capital loss effect than the subprime market will.

Mr. Thompson: The subprime issue is simply a cost of doing business.

Is a risk supported by a captive seen by you (as an underwriter) as a better risk?

Mr. Thompson: Yes. It shows commitment and has more credibility by having the insured's executive leadership involved. It is also easier to underwrite (e.g., it has a funding study attached).

Mr. Hofer: Yes. A captive's existence implies sophistication of management with respect to risk management and claims. These insureds tend to think more strategically in managing risk.

Mr. Curran: Yes. There is a dedication to risk control and claims management. The captive is supported by outside resources that provide a fresh set of eyes.

With your 2008 budgets written and likely including a growth factor (in the face of a soft market), does this budget contemplate you attaching at lower retentions?

Mr. Curran: We are not looking to cut self-insured retentions (SIRs). We want to stay away from the working layer.

Mr. Thompson: We are more of an excess player and will not be looking to lower where we attach. We do not advocate insureds pushing down their SIRs; it's not a good thing.

Mr. Hofer: We are an excess carrier and will remain so. For select accounts, we may drop down.

Mr. Eastwood: We have not been seeing pressure on SIRs.

CICR comment: We are not surprised to hear that there has been little pressure to lower retentions, especially among larger self-insureds. The larger clients of Towers Perrin are generally comfortable with the risk levels that they either elected or effectively were forced to take on during harder market times. As such, they are not looking to bring their retentions down now. They are, however, looking to reduce their excess insurance/reinsurance premiums on the theory that the (re)insurers are attaching well above the working layer, and premiums remain too high. For smaller self-insureds, who may be taking more risk than they should or want to, we believe that insurers may need to attach lower if they hope to maintain their top-line premium, certainly so if they hope to grow it in this continued soft market.

For how much longer will the market remain soft?

Mr. Thompson: I don't know. I feel we are at a point now where both sides are happy with the price—we've reached equilibrium. That said, the soft market could go on for another 3 to 4 years.

CICR comment: We're not so sure everyone is happy. While self-insureds have generally been pleased with the premium reductions they received this year from excess insurers/reinsurers, we believe they will be expecting more (i.e., lower premiums and/or lower retentions) next year.

Mr. Curran: Could be 18 to 24 months ... or more.

Mr. Eastwood: A turn in the market will need to be predicated on a nonmedical malpractice event (e.g., property catastrophe). I think there is the possibility for more compressed market cycles going forward.

Obtaining Maximum Results from Your Captive Team

Moderated by **Keith Becker** of Willis, this session included helpful insights from **Shulamith Klein** of Emory Healthcare, **Bill Cassetta** of Honigman Miller Schwartz & Cohn, and **B.J. Hudson** of Oliver Wyman.

Ms. Klein took the audience through her three-step process, with the panelists offering their perspectives along the way.

Step 1: ***Select the team.*** The chief considerations are expertise, willingness to share information, best practices, relationships between the firms, and philosophy. Ms. Klein also shared her 17-item service provider evaluation sheet (not reproduced here). Many of the criteria she uses relate to the vendor team's interpersonal skills.

CICR comment: We agree that selecting a long-term partner often hinges on some of the "softer" elements of chemistry, trust, fit, etc. This is especially true when one has done a more rigorous vetting of potential vendors on the front end to ensure each has "needed to play" core competencies.

Step 2: ***Establish integrated goals/objectives for the team.*** This includes both identifying and prioritizing them. Per Mr. Cassetta, while theoretically you can do most anything you want, when the captive is your company, the sky is not limitless. You need to do some reality testing.

In terms of implementing one's strategy in pursuit of the established goals, Ms. Klein and Mr. Cassetta both believe that periodic conference calls among the team members are very important and characteristic of higher performing captives. Mr. Cassetta sees some captive owners shying away from this, which he views as shortsighted. Ms. Klein advocates a team approach and team peer review, wherein one circulates preliminary work papers from each team member on which the other advisers review and weigh in. In Mr. Cassetta's opinion, it is better to have conversations in advance among the team, not in front of the board.

CICR comment: We strongly agree. It is important for the team to challenge one another in a constructive manner, resolve any issues in advance, get it right, and communicate things succinctly when the board meets.

Step 3: ***Coordinate team interaction.*** You need to build the "team feeling" and have trust in each other, according to Ms. Klein. What keeps her up at night is not knowing which questions to ask or not knowing what she doesn't know. By having all of her consultants in the room (virtually or literally), she believes it is likely the other consultants will know what questions to ask.

Other take-aways include the following.

- ✔ Ms. Hudson stressed the importance for the actuary to work with the broker (and other members of the team) and vice-versa. Gather the data once, and understand any changes in reserving practices up front.
- ✔ From Mr. Cassetta, bring in the needed expert(s) sooner than later. The broker has the "home court advantage," generally being the more local provider, and will typically be the first to start working on an issue. However, he has seen many occasions where the local broker has marched along a certain path before bringing in a national expert (either that broker's national captive resource or other experts) who then say you can't do what you're planning on doing.
- ✔ In response to an audience question on how clients manage their budgets with this more team-based approach (and the implication that billable hours were accumulating), Mr. Cassetta advised captive owners not to be fooled by all-inclusive large fees where national resources are brought to bear to a situation seemingly at no added cost. All service provider organizations are for-profit companies, he reminded the audience. Further, he questioned, "So how is $350 per hour perceived by some as more costly than a $200,000 annual fee," for example?

CICR comment: We have seen this or a variation on this theme (e.g., stand-alone fees versus commissions buried within the premium line item) countless times. We suspect that these misaligned perceptions have a lot to do with buyer psychology influences.

Fronting Panel Comments

Several of the leading fronting insurers participated in a discussion of fronting issues of the day. The panelists included **Robert Byler** of Amtrust, **Brian First** of SPARTA Insurance, **Christine Lackey** of Discover Re, and **James Obregon** of Liberty Mutual. The session was moderated by **Thomas Kendall** of Captive Solutions LLC. Issues touched on, among others, included the following.

State of the Insurance Marketplace. Mr. Byler characterized it as a very aggressive market, though reinsurer pricing is lagging. Mr. First emphasized that, despite market cycles, providers need to recognize that customer needs are largely unchanged. Their need for control and stability while driving down their cost of risk stand the test of time.

Cost of Fronting. Mr. First and Mr. Obregon generally put in the 5–8 percent range. That is the cost for the insurer to provide its paper and does not include other costs, such as assessments, taxes, claims, or loss control services, for example.

Pure Fronting Avoidance. Why do insurers today shy away from doing pure fronting (i.e., simply providing their paper) when it was more prevalent 6 to 7 years ago? Mr. Byler sees pure fronting as a broken model for group business. There is a tremendous amount of service work required, and reinsurers cannot provide that level of service. Regulatory issues also have a bearing on this trend, he said, with some regulators insisting that the front take a meaningful risk position. Mr. First believes that to do fronting correctly, one needs to think and act like a first-dollar insurer. Accordingly, the insurer may as well share in the risks/rewards of the program.

Form of Collateral Preferred by Fronts. The panel leaned toward letters of credit over trusts, because a trust involved more administration. That said, the insurers indicated they do not charge any differently within their fronting fee based on the form of collateral to be used.

CICR comment: In June 2007, *CICR* conducted a comprehensive survey of fronters and their thoughts on these and other topics. See "Fronters Share Their Captive Wishes," pp. 1–8.

2007 First Cayman Captive Survey

Randy Finley of CHRISTUS Health, **Julie Robertson** of Honigman Miller Schwartz & Cohn, and **Kevin Poole** of HSBC Financial Services (Cayman) Limited presented the results of the Cayman Captive Benchmarking Survey 2007.

CICR comment: This survey seems to complement the annual Captive Insurance Companies Association (CICA) survey, which concentrates on fronting and reinsurance (see *CICR* June 2007, pp. 9–12). Taken together, these two surveys contain lots of interesting feedback from captive owners.

CHRISTUS Health developed the survey, with input from consultants, in response to its captive board's desire for benchmarking information. The Insurance Managers Association of Cayman actually conducted the survey, gathering data during August through October 2007. The survey contained 47 questions in all, including several about the survey respondents themselves.

Some quick facts and figures about the survey and its respondents:

- ✔ 176 captives participated (about a 25 percent response rate). [*CICR comment:* This is quite favorable for a first-time survey.]
- ✔ The principal business of the captive's parent was "healthcare" for 68 percent of the captive respondents, with the next highest categories being "other" at 17 percent and "manufacturing" at 4 percent. [*CICR comment:* The survey is healthcare-biased, even by Cayman standards (i.e., 68 percent of the survey respondents were healthcare, whereas only 37 percent of all Cayman captives are healthcare-related as their primary class of business).]
- ✔ 81 percent of captive respondents were owned by a single parent, the balance were not.

- More than half (52 percent) of the respondents' principal insured(s) had annual revenues of $500 million or less.
- 58 percent of the captives had assets of $25 million or less.
- 45 percent of the respondents' captives were 5 or more years old; roughly 80 percent were 3 or more years old.

Here are but a few of the interesting findings from the survey:

- 42 percent of the captive respondents independently monitor their financial performance using solvency and ratio standards; 44 percent do not; and 14 percent were unsure.
- The top two reasons for establishing their captives were to provide more reasonably priced coverage and facilitate greater risk retention.
- The top three reasons for locating in Cayman were regulatory authority familiarity with the industry, cost of capitalization, and clarity and rapid response from regulating authority.
- The top three captive issues causing respondents the most concern today are stateside regulatory activity, tax compliance, and captive funding.
- The top two insured risk management issues they want to address through their captive are to provide a cost-effective risk retention/transfer vehicle and access to reinsurance.

The survey spans a range of other captive issues:

- Investments (policy matters, manager selection)
- Premium writings (year one, last year/2006)
- Coverage written (year one, now, future)
- Limits of coverage offered by the captive and attachment point (summarized separately for nine different coverages)
- Board composition (number of directors, background, and/or connection to the parent, term of service)
- Board meetings (frequency of meetings and where, regular agenda items, educational topics, duration, attendees)

The complete survey results can be found at http://www.imac.ky/captiveforum/presentations.html.

CICR comment: Those involved in this survey are to be commended for helping to provide some benchmark information often requested by captive owners. The survey is being touted as a first-year effort, with the intent to build on and improve it in each successive year, potentially adding other questions of interest (or deleting those not providing sufficient insights). The trick will be to keep the survey instrument of a reasonable length to encourage optimal participation, while hitting on issues of true benchmarking value for its intended users. ■

Short Reports

Cost of Trusts: At the World Captive Forum, according to Wells Fargo's **Robert Quinn,** the cost of reinsurance trusts from captives is much more favorable these days than the cost of letters of credit. The trusts are costing as little as 5 basis points, with some negotiated at flat fees of $2,000–$5,000 per year. (See *CICR* August 2006, "Trusts as Collateral Alternatives," pp. 1–4 for a complete discussion.)

On Audit Committees' Liability: With all the oversight roles thrust on them, the members of the audit committee might get one wrong. "The audit committee's best defense against liability for material errors in financial reporting is showing their due diligence in respect to their oversight function," according to **Eric Kronewater** of Albright, Persing & Associates, at the recent Nevada conference. ■

CICR Calendar

March 5–7, Phoenix, AZ: Captive Insurance Companies Association (CICA) annual conference. See www.CICAworld.com. ■