

Vermont Captive Insurance Association Special Section

Green Mountain Momentum

Topics broadened to reflect current event and feedback

By Michael J. Moody, MBA, ARM

Many insurance professionals wonder how the insurance industry can continue to provide such a competitive market. The current soft insurance market has continued longer than most experts expected, and many believe that similar soft pricing will continue into the near term.

As a result, past history as well as conventional wisdom would suggest that corporate insurance buyers would be less interested in alternative risk financing products, such as captives, during these soft market conditions. This has been true for previous extended soft markets and a quick review of some of the major captive domiciles would indicate that this appears to be true for many domiciles, but not all domiciles.

So much for conventional wisdom

Despite the growth of dozens of new state captive domiciles, for the most part the soft market has been difficult for them to deal with. For those new domiciles, as well as many of the more established domiciles, new captive formations have been few and far between during 2009. But not so for Vermont, the largest U.S. domicile.

And to say that Vermont is bucking the trend does not do it justice. According to David Provost, deputy commissioner of captives, the State of Vermont licensed a total of 39 captives last year. He points out that “for the most part these were single parent captives,” or, as they are known in Vermont, “pures.” But he says there were other types of captives as well.

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Deputy Commissioner of Captives
The State of Vermont



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—Dan Towle
Director of Financial Services
Vermont Department of
Economic Development



Vermont also continues to attract risk retention groups (RRG) as well, says Provost. And he points out that, as with most RRGs that are formed today, the majority of these were involved with medical professional coverage. However, he believes that activity within the RRG sector should pick up when Congress approves the Risk Retention Modernization Act, which will allow RRGs to also write property coverage. This should be good for the industry as a whole, he points out:

“For example, if we write a group day camp and part of the exposure is buses, we can now cover their liability exposure in the RRG, but not the buses.” But the changes to the RRG act should be able provide coverage for the buses as well. And he adds, “It just makes sense to use the RRG to handle the property coverage.”

While Vermont has had little involvement in putting employee benefits into captives (e.g., group term life or long-term disability), Dan Towle, director of financial services for the Vermont Department of Economic Development, says, “We still have questions trickle in about employee benefits, but it really needs to be the right fit.” And, as Provost notes, there are still some issues with the corporations themselves, such as a human resources department not being on the same page as risk management. Obviously, he says, “There is still a significant communication gap in some corporations.”

In addition, Towle points out that people are waiting for the “dust to settle and see how the new federal health program unfolds.” At this point there are many unanswered questions, but Towle is optimistic that “the new law could encourage more captive involvement.” So for the time being, it is just a waiting game.

Obviously, 39 new captive formations in 2009 was a great year, by any measure; but what is 2010 looking like? Provost notes that as of May 15, 2010, Vermont had 12 new formations and has three applications pending. In addition, he says that they have an additional 25 others “in the works.” These are organizations that have talked to the state regulators and are planning on submitting an application. While Provost says it is difficult to predict exactly how many of these will become captives, he is confident that at least half of them will complete the application process before the end of the year.

Beyond the numbers

Why are there still companies that are choosing to form captives? Towle and Provost have a pretty good idea. Towle says, “Captives can be formed to solve a specific problem during a hard market, thus filling some short-term need.” But the organizations that are forming captives today have a broader view for their captives. He points out that most of these corporations “view their captives as long-term risk management solutions.” He goes on to note, “Companies that are doing them today are now doing them for the right reasons, and they are in it for the long term.”

Provost adds that today we are not seeing companies panic and coming in saying, “We need to do this now because we can’t get the coverage.” Rather today, “It is all about risk management and preparing for the future.” He goes on to say, “They are running their businesses correctly, and it make good sense to have a captive.” It’s apparent that the current risk management

community is seeing the real value of a captive. “They are looking at it more strategically and from a problem solving standpoint.” For example, he says, “We have had two or three construction companies start captives this year; and since they are not being overwhelmed with new business, the captive formation was much more strategic for them.”

Towle notes another interesting trend is developing in Vermont. “Captive formations are no longer just one line of business or for a Fortune 1,000 corporation.” More than ever, he says, “We are seeing smaller and mid-cap companies forming captives.” Even smaller, family-owned businesses are forming captives, Provost adds. “Vermont is equally adept and capable at handling a workers compensation captive for the mom and pop organizations as we are for doing huge Fortune 500 companies,” he says.

Conclusion

Based on the results so far, one might think that Vermont has radically changed its approach to captive formation; but nothing could be further from the truth. As Towle put it, “We haven’t really changed our strategy; we are still looking for quality companies that want to start captives for the right reasons.” And, he notes, “This has been our approach for the past 30 years.” In fact, the entire Vermont captive community is directed at attracting and retaining quality captive formations. Towle says it is a great partnership and “one of the key reasons we continue to be so successful.”

Vermont’s continued success is surprising in light of current market conditions and the experience of other jurisdictions. And one of the biggest surprises of late is the growing interest of the middle- and small-sized corporations in captives. It is important for independent agents and brokers to recognize this major trend in the direction the alternative insurance market is moving and prepare to participate. It is no longer acceptable just to find property and casualty insurance solutions for your better accounts. Chances are high that, regardless of size, they may be ready to move to a more strategic approach to risk management that could involve some level of self-insurance via participation in a risk retention group or a captive.

The real question becomes will your agency be in a position to help these customers take this important step? If so, the Vermont captive community is ready to assist you.