● CASE STUDY

The Race for the Middle Market

Captive insurance options for middle market firms and small businesses have exploded as the scandals plaguing the regular commercial insurance industry renew interest in setting up shop onshore where regulators are less likely to raise a stink, according to captive industry officials.

BY THOMAS J. SLATTERY

In the eyes of captive insurance industry proponents, the future of the business lies in addressing the needs of middle-market corporations and small businesses. Those businesses, proponents of the captive industry say, have the same needs as larger corporations.

"I think one of the perceptions about captives is that they are only for large companies, which is absolutely not true," says Daniel D. Towle, director of financial services in Vermont's Department of Economic Development.

Towle cites a query his department did not long ago that showed more than 150 of Vermont's 700-plus active captives write less than $5 million in premium. "If you look at the marketplace of companies writing less than $5 million in premium, there's a lot more certainly than the *Fortune* 1,000 companies as a marketplace."

Towle also says that these days there are more options for middle-market companies looking for captives. "There are a lot of group programs

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accepting members for their specific niches," he says. "We're seeing strong growth in our sponsored captives. Liberty Mutual is certainly the most notable. That's going to start to fill a need. Liberty has communicated that there's a real demand from its existing customers to do what they're doing offshore in Bermuda in an onshore domicile. So we're expecting to see a lot of growth in that sector."

[See related story on Liberty Mutual's move to Vermont on page A 14.]

AN ONSHORE BREEZE

Why the preference for an onshore domicile for those targeting middle-market business, among others?

"Perception, unfortunately (or fortunately, depending how you look at it), drives that sometimes," says Towle. "In light of everything that's going on in the current marketplace, with Eliot Spitzer and corporate governance, I think many more boards of directors are just choosing to stay at home and not have to deal with the negative perception of being offshore."

He also thinks the marketplace has recognized the opportunities and possibilities of the onshore marketplace.

"In the past, it was believed that much of what you could do in the captive arena had to be offshore," he says. "That's clearly not the case. Most of the tax advantages have sort of whittled away over the years."

A case in point, Towle also says, is Chicago's Attorneys' Liability Assurance Society Inc., a risk retention group composed of 300 law firms from around the United States.

A.L.A.S., which has provided services for 25 years, furnishes professional liability coverage for about 50,000 lawyers. That includes loss prevention services through publications, audits, in-firm presentations and telephone consultation services.

Its loss prevention unit, all former lawyers in member firms, responds to more than 2,000 inquiries from member firms each year. Firms eligible for membership must have 35 lawyers or more to apply. A.L.A.S. serves small to midsize firms, as well as large firms.

"Our business model is to provide stability and coverage," says Mark Gralen, the group's senior vice president for member services. "We have, I think it's fair to say, the largest limits in the industry in one policy. We pride ourselves on offering broad and stable coverage to our members on a year-in, year-out basis."

The second pillar of the A.L.A.S. business model is excellence in claims handling by partner-level lawyers and top notch loss prevention services. Then, too, there's underwriting service beyond just the issuance of the policy.

"In 1996, we became a risk retention group. Prior to that we were an Illinois captive," says Don Breakstone, senior vice president and general counsel of A.L.A.S. Then the decision was made to move to Vermont. The organization moved to Vermont, says Breakstone, because Illinois changed its captive law and it became impossible to form the risk retention group there, convenient as that would have been.

"Vermont had an excellent reputation as a regulator, and the largest number of captives, particularly risk retention groups," he says. "We wanted to be associated with a jurisdiction that had the highest quality of captives and provided the highest quality of regulatory service to insureds and to insurers."

The big issues for A.L.A.S., says Breakstone, are stability in terms of coverage and pricing, strong loss prevention to help avoid systemic problems in its member firms, and anticipation of new trends in exposures lawyers face.

And just how does A.L.A.S. market to middle-market firms? "We've never really marketed to anybody," Breakstone says. "The facility has always developed largely by word of mouth. It's usually members that give us a name, recommend a firm."

The appeal of A.L.A.S. to small and midsize firms depends on what the firm does. "What we emphasize, putting aside broad coverage, are two key factors," he says. "No. 1 is our loss prevention program, which helps any size firm in the management of risks and understanding what risks they may face, be they a small firm or a large firm. No. 2 is claims management, where we spend a great deal of effort managing claims in the interests of the firm, which is just as important to a small firm as to a large firm."

"A small law firm of 50 people could be a firm that specializes in complex litigation or a firm that specializes in certain types of specific corporate work," says Breakstone. "And they have no different interest than in a megafirm that has the same type of practice."

In the traditional insurance world, the small law firms were lumped into the same pot with the accountants, individual lawyers and others who buy professional liability.

"They believed that law firms, as a separate risk group, could

form their own captive which, writing on a preferred risk basis, carefully choosing which law firms would be members of a mutual company they wanted to create, could do as well and probably do much better than the commercial market in writing coverage and in helping firms develop a loss prevention concept, which the commercial market had never pressed."

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The difference in the demands of the smaller members and the larger members depends on the firm's practice.

"For example, a small firm that did divorce law or all criminal law would probably need a different type of protection," Breakstone says. "Our smallest self-insured retention now is around $250,000. Our smallest limit is $10 million. So if a firm has a practice that doesn't merit that kind of coverage, then they would be less interested in A.L.A.S., although we've had firms that are very small that have joined and stayed because they like the risk management." Those very small firms, he says, have stayed because they've had a good claims experience with A.L.A.S., compared with their claims experience in the commercial market.

Regardless of size, any firm active in the litigation or corporate-oriented and patent fields, for example, would be as interested as anyone else. Then too, he says, A.L.A.S. has never varied its rates. "We have a unitary rate, so everybody pays the same and buys the same limits and retention. So there's never been discrimination one way or the other among the various firm sizes." In short, in the end, it's all the same, big or small.

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