Vermont
CAPTIVE INSURANCE
ASSOCIATION

Vermont Captives - 2011: On Target for a Record Year

State's reputation keeps it in the forefront of domiciles

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Captive growth worldwide continues despite what many predicted would be a short-lived phenomenon because of soft market pricing. With the current soft market now approaching its 10th year, captives have continued to gain market share.

Although many captive domiciles are experiencing strong growth, by far the most successful is Vermont. Vermont had seven new captive formations during the first quarter of 2011, making it the strongest first quarter since 2005. As David Provost, deputy commissioner of Vermont's Captive Insurance Division, points out, "Obviously, the first quarter tends to be our slowest quarter of the year." He also notes that the current pipeline for new applications is in good shape.

A key factor that distinguishes Vermont from other venues is its responsiveness to captive owners and service providers. Nowhere is this more evident than with regard to keeping the state's captive legislation up to date. In May of this year, for example, the governor signed into law a bill that allows cells within a sponsored cell captive to be formed as incorporated protected cells.

Noting that the legislation was submitted in response to numerous industry requests, Provost explains that it "will remove some of the restrictions on the types of business allowed to be written in the cell." Further, he says, the incorporated cell option will not weaken the rights or protections offered by the traditional cell structure. Dan Towle, Vermont's director of financial services, adds that the incorporated cell feature will "expand and help open the door for smaller companies."

Another important feature of the new law is that it makes permanent the first year's premium tax credit that new captive owners have been

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Deputy Commissioner
Captive Insurance Division
State of Vermont

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enjoying for the past 18 months. The new law also addresses perceived restrictions regarding who may be a cell owner, and reinforces the fact that the insurance commissioner will have full discretion in deciding who may be a sponsor.

Emerging trends

These changes to Vermont's captive legislation indicate the state's ongoing interest in attracting cell captives. Although cell captives are still a small percentage of Vermont's total (fewer than 20 cell captives out of 580+ active captives), Provost comments, "We are having a significant number of discussions about them." Towle notes, "While these initial discussions do not appear to be producing anywhere near what the buzz would suggest, it continues to be a topic that everyone wants to talk about. By making the recent legislative changes, we believe we will have more conversations."

Another trend, the inclusion of employee benefits in a captive, is similar to the cell captive situation. "This has been a topic for a long time, and we felt it was going to be a large growth area for us," Towle says. "At this point in time," however, "unless something at the federal level changes, which would create some new opportunities, we believe that there will be only modest growth, probably in the range of three to five per year." Many people continue to believe that one of the biggest impediments to having more employee benefit programs within their captives has been internal concerns between corporate human resources and risk management departments.

One of the hottest growth areas for Vermont has been risk retention groups (RRGs). Provost says that Vermont has licensed two new RRGs so far this year and that both were formed to cover professional liability risks: one for physicians and hospitals and the other for attorneys. Going forward, he says, "We expect to see a steady flow of medical professional liability RRGs." He points out that the RRGs "help to focus the attention of both doctors and hospitals on preventing losses, not just financing the losses." In the long term, Provost notes, "This should really improve medical care."

Another key trend is ongoing captive activity in the middle market. Towle notes that Vermont has benefited greatly from this trend, as "about half of our business has come from small to mid-size accounts." Provost adds that "three of this year's new captives are small businesses, and of that number two are family-owned businesses." Further, Towle notes that, although Vermont has a reputation for attracting Fortune 500 companies, "We have always been a home for smaller captives as well." This is a trend that Towle sees continuing and growing faster than the general captive market, because "This is all about control. Regardless of size, corporations today want to control their insurance costs and control their risks," he remarks. Even small companies, Towle says, now realize that "there is no better way to do this than in their own insurance company."

Other concerns

Captive insurance companies have become a mainstay in the alternative risk financing arena, and their future appears bright. Many industry observers expect a hardening of the traditional insurance market in the near future. "Obviously," Towle notes, "interest in captives spikes during a hard market." Owners who have established their captives during the soft market "are doing this for all the right reasons," he says. "They are planning to develop long-term risk management solutions, not just for their immediate needs."

Organizations that wait to form captives until the market hardens will have to act with a sense of urgency.

When the hard market arrives, Provost says, "The growth of the alternative market in general, and captives in particular, should help to smooth out some of the cyclical nature of the traditional market." Over the years, it has become clear that, once organizations move into the alternative insurance market, they typically do not go back to the traditional market.

The number of captive domiciles is growing, both offshore and onshore. Although each domicile has advantages to offer prospective captive owners, few can boast a list as impressive as Vermont's. Despite the departure of several key personnel, as well as the election of a new governor, the Captive Insurance Division continues to license new captives.

A critical part of any captive feasibility study is an analysis of the available domiciles. In that regard, Vermont has few real competitors. Its list of advantages continues to grow, and regulatory issues are addressed as soon as practicable. The Vermont legislature is one of the insurance department's strongest supporters and is in concert with the department's long-term vision. Third-party service providers are also aware of Vermont's reputation, and they take great pains to maintain it.

Finally, the half-dozen people that make up the nucleus of the Vermont captive movement are dedicated professionals with a passion to demonstrate the value of owning a Vermont captive. This proves the truth of the adage "The more things change, the more they stay the same." ■

The articles in the VCIA Special Section were written by Michael J. Moody, MBA, ARM, vice president - alternative risk of The Rough Notes Company.