Group Captives:
An Opportunity to Lower Cost of Risk

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Group Captives: An Overview

Participation in a group captive can help companies save on insurance costs and provide access to extensive risk-management resources, including industry-specific expertise. These attributes are a source of value in the best of times, and today's inflationary conditions may increase their appeal for certain types of companies.

A captive is generally defined as an insurance company that is wholly owned and controlled by its insureds to cover its owners' risks. It's not the same as a mutual insurer, despite a mutual being technically owned by its policyholders. In a mutual, the policyholder has not invested any assets in the insurer and does not actively participate in running it.

A group captive is most commonly owned by a collection of organizations, rather than a single parent company. Typically, each owner makes a modest initial capital contribution. The lines of coverage written usually are those with more predictable losses, such as workers compensation, general liability, and automobile liability and physical damage.

The group captive funding model

Group captives commonly use the A/B Fund model, which allows for risk sharing and is based around members' commitment to safety and loss prevention and desire for greater control of insurance costs. The model funds losses on a per-occurrence basis and benefits companies that can minimize loss frequency.

The A/B Fund model is the most common funding model for group captives.

- The A Fund ("frequency layer") holds the majority of the forecasted loss dollars.
- The B Fund ("severity layer") holds the remainder and covers losses from the A Fund's limit to the captive's overall retention limit.

The A/B Fund model provides specific excess insurance and aggregate excess insurance, which allow each captive member to handle expected losses while transferring potential catastrophic losses. It also allots assessments for exceeding expected losses, which are well defined and limited, and known to the member up front. The model provides members direct access to reinsurance that would not otherwise be available to them in the commercial insurance market.

To help manage risk within the captive, group captives can also provide "basket" coverage which insures against losses applicable to multiple lines of coverage stemming from the same incident, and "clash" coverage that safeguards individual members and the captive as a whole, when multiple members are involved in the same incident. Generally, these coverages would apply a single retention and limit in each respective situation.

The model provides financial transparency and cost stability, which are very compelling for financial executives and owners of mid-sized companies.

A/B Fund Layers: $400,000 Captive Retention

B Fund: ***Severity Layer***

$400,000

Contributes to the remainder of the captive retention

- Contributes to claims in excess of $100,000 per occurrence
- Contributes towards risk sharing/shifting

A Fund: ***Frequency Layer***

$100,000

Pays for the first $100,000 of each loss

- Pays for claims between $0 - $100,000 per occurrence
- Pays for the first $100,000 of any loss

Note: Retention levels vary by captive. Most common A Fund layer is $100,000 to $150,000; most common B Fund layer $350,000 to $400,000

Read more: A Comprehensive Evaluation of the Member-Owned Group Captive Option

Why join a group captive?

Joining a group captive often results in a reduced insurance premium. This is due to the fact that, in a group captive, each member's premium is based on its own most recent five-year loss history.

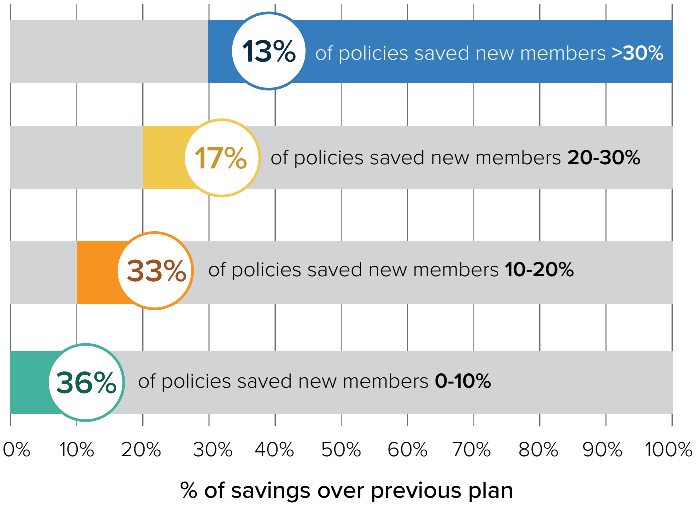
Group captives recruit safety-conscious companies with better-than-average loss experience. This contrasts with commercial carriers which base premium on a number of factors including industry-wide loss experience, statutory requirements, and overall portfolio performance. This more expansive risk pool can result in higher premiums than a lower-risk company may obtain as a group captive member.

By the second and third year of membership, the increased focus on holistic risk management and post-loss claims management can drive members' premiums down even further.

According to a recent study, almost three quarters of new bound policies in group captives resulted in lower premiums compared to members' previous plans. Many members enjoyed significant savings, with roughly 30 percent of new policies producing savings of 20-30 percent or more.

How Much New Members Save

72 percent of new members lowered costs vs. previous insurance plan.



Source: Captive Resources' analysis of 1,000 new bound policies across several group captives compared to the costs of the member-companies previous insurance plans.

What kinds of companies join group captives?

Most companies that join group captives are safety-conscious, despite often being entrepreneurial risk takers.

"While they embrace the risk-reward trade-off, they're not gamblers," says Sandra Springer, SVP of Marketing for Captive Resources (CRI), a leading consultant to member-owned group captive insurance companies since 1984. "They are successful, financially stable, well-run companies that have confidence in their own abilities and dedication to controlling and managing risk. They believe they will outperform actuarial projections, and a large percentage of them do."

Group captive members tend to have reasonably strong safety and risk management programs in place with the intention of taking these programs to the next level. A strong safety culture is essential, and member companies are continually focused on building one. As a group captive member, this comes with the potential for significant rewards – including a safer company and employees, lower losses and premiums, and dividends for better-than-expected performance.

Additionally, companies joining a group captive are amenable to sharing risk with like-minded companies and understand that fellow member companies will be held accountable when it comes to controlling losses.

"There is remediation support available for members that need to improve their risk management performance," Springer adds. "It's all part of the group dynamic where we observe members supporting one another, sharing best practices, and helping each other to succeed in the captive. After all, they're fellow owners of the captive insurance company, so when individual members succeed, it only makes the captive stronger.

"Members are motivated by the benefits they can reap. Ultimately, they're confident sharing risk with like-minded companies for the potential rewards."

Member benefits

In addition to the potential for premium savings, group captives tend to benefit members through greater financial flexibility and protection against losses. This is due to greater control of and transparency into insurance program costs.

Improved risk management and safety is often considered one of the top benefits of group captive membership. Extensive resources and support with both pre- and post-loss focus, as well as continual measurement, drive continuous improvement. Jamey LeBlanc, EVP Risk Management Services at CRI explains, “The benefits of a group captive in joining safety performance with direct impact on premiums paid, provides members a strong incentive to drive higher levels of engagement in safety across their companies. Additionally, the many resources that are available to them in both safety and claims oversight, provide state-of-the-art tools and solutions to deploy in improving their safety programs and also making them more efficient and effective safety leaders.”

Group Captive Members Are Safer than the Average Company

Across 15 mature group captives & 1.5 billion work hours, members had:	Industry Benchmarks	Member Performance	Difference
48% **fewer fatalities**	41 Average fatalities	21 Actual fatalities	20 Fewer lives lost
39% **fewer lost time claims**	8,635 Expected lost time claims	5,281 Actual lost time claims	$153M Saved on lost time claims
22% **fewer total WC claims**	25,667 Expected claims	20,099 Actual claims	5,568 Fewer claims

Source: Independent actuarial analysis based on actual WC exposure and claim data of group captive member companies advised by Captive Resources, compared to national industry data from the Bureau of Labor Statistics. Average claims costs by type of injury from the National Council on Compensation Insurance were used to quantify the financial impact of the differences in claims frequency.

Group captives can also help lower costs via greater member involvement in the insurance process, including oversight of claims handling and reporting. These lower costs can improve cash flow for certain risks, with the return of unused loss funds and investment income via dividends.

Group Captives Offer Opportunities to Earn Dividends

$5.6B
Group captive members paid $5.6 billion into their loss funds (to pay out claims costs)

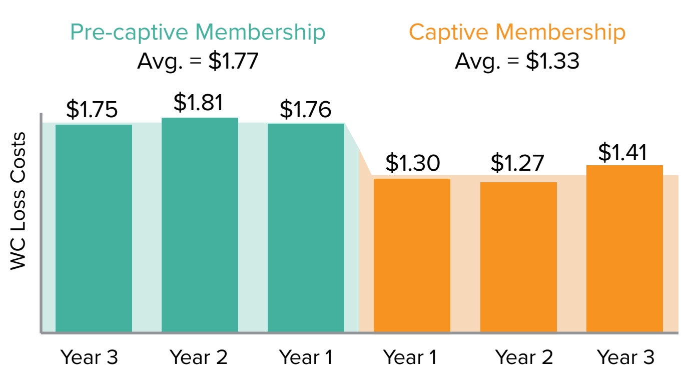
Unlike traditional insurers, group captives return underwriting profit to their member-owner insureds.

$1.3B
The captive members earned $1.3 billion in dividends (23% of loss funds)

Source: Captive Resources study of 15 mature group captives across 233 closed accident years

Moreover, workers’ compensation loss costs declined substantially after joining a group captive, with significant improvement beginning with the first year of captive membership, as illustrated by the chart below.

Average WC Loss Costs Before & After Joining a Group Captive



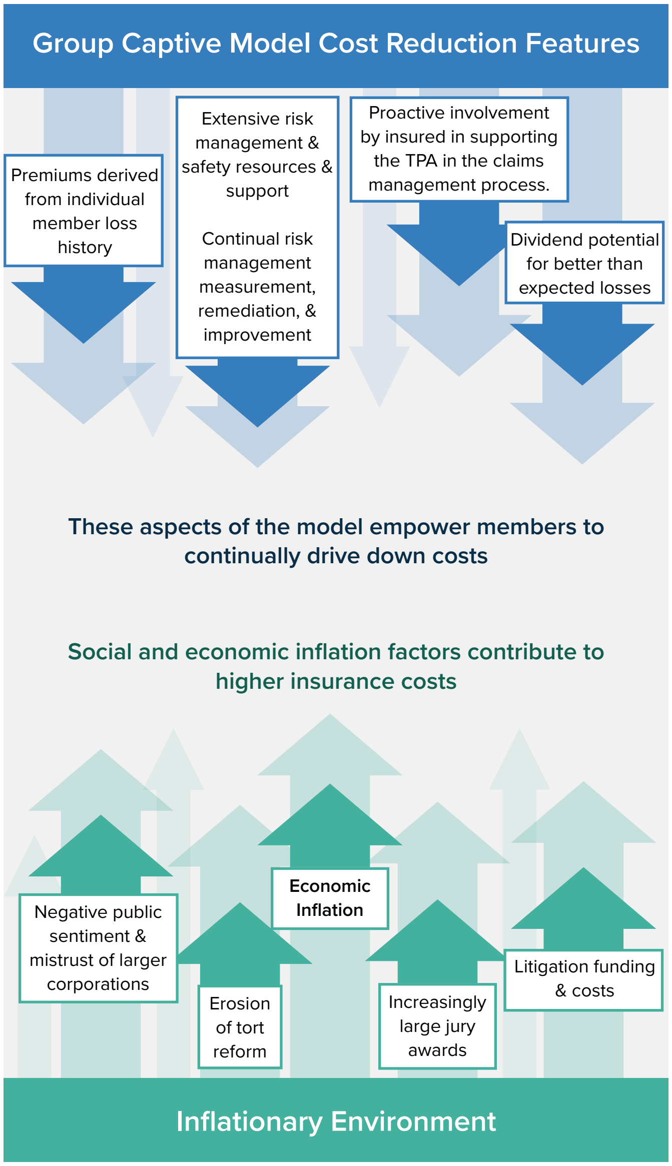
Source: Independent actuarial study of member companies across 8 group captives advised by Captive Resources. Study focused on workers’ compensation using average loss cost per $100 of payroll as a measure of performance.

Heading off litigation costs

Attorney involvement in commercial auto claims drives expensive litigation and settlement delays that inflate companies' expenses. The trucking industry in recent years has experienced a rise in costly lawsuits due to increasing crash frequency and severity. A 2020 report from the American Transportation Research Institute found that average verdicts in the U.S. trucking industry grew from slightly more than $2.3 million to almost $22.3 million between 2010 and 2018 – a 967 percent increase, with the potential for even higher verdicts looming. Similar litigation costs are affecting several other lines of insurance, as well.

In the face of dramatically rising litigation costs and jury awards, it becomes even more important for insureds to focus on effective post-claim mitigation strategies. Group captives can help member-insureds control these rising costs through claims monitoring and review, often through providing additional layers of support that improves claims adjusting effectiveness and efficiency. Julie Springer, SVP of Claims for CRI explains, "The group captive model creates a strong partnership between the member (insured), adjuster, broker, and carrier based on increased communication and aligned goals. That's a dynamic that may not be available in a traditional commercial insurance arrangement." Given that members' premiums are derived from their own loss history, this is yet another way that they are able to lower their premiums, proactively managing and controlling the losses that do occur.

The graphic on the right illustrates how aspects of the group captive model empower members to control the rising costs in today's inflationary environment.



Group captives moving forward

Group captives are an option for mid-size companies that are committed to risk management and safety and have a desire for greater transparency into their insurance programs. They can provide a viable way to protect companies across several lines of casualty insurance. Their prominence is likely to grow as economic and litigation trends continue to increase costs, prompting companies to continue to seek effective risk financing programs offering superior cost control.