Captive Cells Come to the Nation's Capital

By: Dick Goff

There are moments when explorers are poised to make a great discovery. As when the Lewis and Clark expedition pushed off for the first time up the Missouri River... Or when Neil Armstrong stepped onto the surface of the moon... Or when Bill Gates started tinkering with a PC operating system...

At the risk of being accused of bald hyperbole, I think a discovery of nearly the magnitude of those historic events is ripe to be made in the alternative risk transfer (ART) community, and that is this:

Any DC-licensed captive insurance company can offer segregated cells that protect occupants and the overall company from losses by any other cell occupant. This improvement in the DC captive regulations removes the requirement that a recognized insurer sponsor a segregated cell captive.

Just three of the many enormous implications are these:

- *Risk Retention Reporter*, an industry pulbication, told its readers that Risk Retention Groups (RRGs) may now create segregated accounts. This should be extremely attractive to RRGs formed to cover the liabilities of many different parties.

- Now major national assocations can sponsor captives in which their state or local affiliates own their own cells - in effect, their own mini-insurance companies - to cover their unique exposures without spreading risk to other members of the captive.

- In another example, the sponsor of a medical malpractice captive can offer separate cells to physicians who will be able to participate in underwriting and investment income while obtaining coverage at the best possible premium levels.

Industry service providers can now be instrumental in establishing captive insurance vehicles that can provide major benefits to self-insuring organizations and large populations of insured persons, while also enriching themselves.

All they have to do is declare themselves to be in the game, and they are in the game. These may be TPAs or MGUs, and they may also be brokers, consultants, agencies or even traditional insurance companies.

The major motivations to get in to the captive ownership business could be to establish a viable new profit center, and to participate in a risk selectively - not just stand on the sidelines and collect fees for service. For TPAs, especially, captive formation provides benefits of both business continuity and business perpetuation. Clients gathered into a captive are likely to stick with the administrator over the long haul. And a burgeoning book of captive business will increase the company's value if it becomes an acquisition candidate.

The risk funding structure that empowers industry servcie providers to confidently enter the risk-taking business with a captive is the segregated cell structure. Segregated cells legally separate silos of risk that are protected from all other cells or the captive as a whole. Cells can be established according to the captive owner's strategy: by individual client; by client group; by size of exposure; by type of exposure - any way that makes sense.

And one of the most powerful structures is the segregated catastrophe loss cell (CAT cell). This is a cell that holds specific identified risks or unknown future risks of certain types or exposures. In a medical benefits captive, the CAT cell would cover risks that in traditional plans may be "lasered out." These exposures would be covered by the CAT cell, which is funded by premium paid by all cells within the captive as the first layer of reinsurance.

Think of the competitive advantage that would be realized bya a captive that offers employers a plan to cover all employees without regard to past experience or future exposure. And, in additiona, may allow insured employers to also participate in their cell's underwriting and investment income (optional).

If that's not a win all around, I'll eat this magazine with milk and sugar for breakfast. But, as they say in the ginsu knives commercials, wait, there's more!

Some industry service companies have quietly owned captives in the Cayman islands, or other offshore domiciles, and when they insure certain risks through them are treading a fine legal line. Any risks that qualify under ERISA and are regulated by the DOL may run afoul of these regulations if covered by and offshore captive. By redomesticating these captives to the District of Columbia, the captive owner(s) could strike up the band and begin marketing aggressively.

An service providers in states where assessments are being levied on health insurance of stop-loss insurance to support hight risk pools could be heroes by providing a captive solution to employer clients. Suddenly there's no insurance to tax because the captive is not providing medical reinsurance and it only answers to the regulators within its state of domicile.

Service provider-formed captives: One small document for the originator; on giant leap for risk management.

Dick Goff is president of MIMS International, Ltd., specializing in designing ART funding structures and managing them through its affiliate, The Taft Companies. He may be reached at rcgoff@mimsintl.com or 800-899-1399.