ART GALLERY FOR FEBRUARY

The captive cavalry is saddling up

None of the curators or docents of the ART Gallery required improvement necessitating New Year's resolutions, but we did offer a prediction for 2009: more companies will establish captives to insure employee benefits now that the practice has practically become mainstream.

With approval by the Labor Department for two big employers to fund employee benefits through their captives, the momentum is clearly perceptible: since 2000 DOL has approved 17 captives to provide benefits risks including long term disability, life insurance and AD&D in various combinations.

Most recently DOL doled out imprimaturs for benefits coverage by United Technologies Corp. and the German delivery giant Deutsche Post AG that employs many Americans in its DHL Express subsidiary.

United Technologies of Hartford CT (of which I will never be a customer for its jet engines) was approved for its captive United Technologies Insurance Vermont (UTIV) to reinsure group term life, accidental death and dismemberment, and long-term disability policies. A CIGNA Corp. unit will write the group life and AD&D policies, while the LTD policies will be written by a unit of Liberty Mutual Group Inc. According to a report by *Business Insurance*, the fronting insurers will reinsure 100% of the risk with UTIV.

Deutsche Post AG, with worldwide revenue in 2007 of about $100 billion, currently insures benefits of employees outside the U.S. with captives in Luxembourg and Bermuda (counter-seasonal annual meeting venues, I surmise). Under the arrangement sanctioned by DOL the Vermont branch of the Bermuda captive will reinsure LTD policies issued by Prudential.

All of the good reasons for insuring benefits and other risks through captives apply especially this year when money is tight and the traditional insurance market is hardening. "Hardening" may be understatement as certain areas of insurance come to resemble the Petrified Forest of Arizona.

To review principal advantages of insuring benefits programs in captives we offer these two:

- Cost savings. Assuming the benefit program was previously fully insured before migrating to the captive, employers typically reduce risk-financing costs and retain investment income. Cash flow for corporate programs can be ten percent or more. Benefit programs may be treated as third party insurance for tax purposes for the further financial advantage of deductibility.
- Improvement in the benefit program itself. Everything about a benefit program that is owned and managed by an employer naturally comes under greater scrutiny and strategic focus. Usually the procurement process is improved and the program experience is carefully monitored. Claims are handled more appropriately and overall experience improves.

Group health in play

All the reasons to form benefits captives especially apply to insuring group health programs, and the market is broadening. While large employers are mostly (86% according to latest estimates) self-insured, smaller companies have joined the trend with appropriate stop-loss coverage. These groups all have the option of joining pools comprised of group, agency or association captives.

Group captives can overcome DOL's "party of interest" concern by removing individual employers from direct ownership of the captive while still providing most of the advantages. Employers may still expect such benefts as cost savings over time, investment income, underwriting input and increased transparency with the carrier.

A recent presentation by Strategic Risk Solutions reported that agency captive programs have been established to cover limited medical, stop-loss, pharmacy, dental and vision while association captive programs now cover fully insured major medical, limited medical, stop-loss and occupation accident risks.

One of our favorite forms of ART is risk retention groups (RRG) formed with federal preemption under the Liability Risk Retention Act (LRRA) but the ability of RRGs to provide medical stop loss insuring through a contractual liability coverage form is still inconclusive. Last year's case in California forced an RRG to buy a fronting policy rather than issuing directly, but other RRGs continue to provide medical stop loss coverage and several states are reviewing new programs.

Every company that contemplates forming a program under ERISA must be fully briefed on all potential issues it involves, including the possibility of outright change by a new Congress anxious to reform the health care system.

Surely, lower health care costs over time and increased transparency with an insurance carrier create a favorable scenario for these programs, but the area is a prime example of *caveat emptor*, Latin for watch out for your wallet, bub.

Allen Taft is founder and president of The Taft Companies, captive brokers and managers in Bermuda and many U.S. domestic captive domiciles.