D.C. Captive Law Provides New Opportunity for Associations

By Jay Younger, McKinley Marketing

As the nation's newest captive insurance domicile, Washington, D.C. is attracting attention for its businesslike approach and special advantages.

The pressure on the property and casualty insurance market has begun to hit home, and associations are beginning to feel the pain. A "hardening" market has led to significant increases in premiums and a general lack of supply in some segments of the commercial insurance market.

Take the case of the National Association of Metal Finishers, who has been sending notices of non-renewal. Now, NAMF is faced with the challenge of finding another option, which is a daunting task given the fact that most insurers are reticent to enter their market. "We're going to take a look at all of our options," says Josh Gold, CAE, NAMF's executive director. "Naturally, that includes the possibility of forming a captive insurance company."

The District of Columbia's Captive Insurance Company Act of 2000 provides significant new opportunities for organizations to insure themselves instead of seeking insurance on the traditional commercial market. A captive insurance company, or captive, is an insurance company owned by members of a common industry or association in order to share the risks of that industry among its members. Captives have actually been around for quite some time, but most were domiciled in overseas locations like Bermuda or Grand Cayman. Now, with the District's new legislation, associations headquartered in and around the nation's capital are beginning to take a closer look at captives.

Captives allow groups to take financial control and manage riks by underwriting their own insurance rather than paying premiums to third-party insurers. The potential advantages of such self-insurance include lower costs, protection better tailored to the organization's needs, more control over risks, tighter control over financial and information resources and the potential to realize significantly more income. The D.C. legislation has addressed one of the typical concerns of forming a captive - capitalization. The commission included a proviso that allows a letter of credit from a financial institution to stand as a form of collateral. Typically, these letters of credit can be secured for a small percentage of the total amount of the line of credit extended. Then, once the captive is up and running, there are other financing options that can eliminate the need for the letter of credit.

Of course, a captive is a risk taking entity, so there will always be an element of uncertainty that must be considered. Still, the insurance industry has been built on the practice of forecasting and managing risk, so it's quite possible that a captive could be less "risky" than one might think. By establishing a loss profile in advance, and perhaps limiting the amount of an association's exposure by working with the reinsurance market, captive managers can typically do a very good job of forecasting losses. This means that associations with conservative investment policies or bylaws might still be able to satisfy those with a low tolerance for risk.

The new D.C. legislation, coupled with the "hardening" insurance market, has led many associations to consider the captive model as an opportunity to improve member service and drive non-dues income. Also, organizations that already have a captive insurance company, regardless, of its domicile, may question whether they are maximizing its financial leverage or risk-taking capabilities, or is it registered or operating in the right domicile. Since the commercial insurance market will likely remain volatile, this may be an opportune time to consider the long-term solutions that captives can provide.

Sources: MIMS International, District of Columbia Department of Insurance and Securities Regulation