

A Shared History

When Roads Meet



Funny how things turned out when I moved to Vermont 24 years ago to work for Ernst & Young. Two years before, the Vermont Captive Insurance Association (where

I was later Chair and a board member) was born. A few years prior, the first Vermont captive was created. I believed the fledgling captive industry was ready to take off then. Boy, did it ever.

Fast forward years . . . decades . . . another century. I ran captive operations for Willis, then joined Towner Management, now celebrating its 20th anniversary. Meanwhile, VCIA had its silver celebration last year. Vermont celebrated 30 years of captive existence in June. Lots of milestones and a lot more gray hair as the Vermont captive industry evolved from pioneers to leaders.

Now, in 2011, more states have captive legislation than don't, but one state still leads. If not for Vermont—still an industry giant—and the VCIA, captive insurance wouldn't have looked the same. I think we're all grateful to arrive at the same place—success.

Guy Ragosta
CEO

What to look for in a Captive Domicile

While so many considerations are critical to the success of your captive program, perhaps none is as strategic as finding the right domicile partner. Finding your perfect match can be daunting because making mistakes now can cause you grief later on.

You can, though, make the correct evaluation with a systematic approach, a little leg work and some input from knowledgeable industry veterans. Consider these fundamental factors when searching for the perfect domicile for your captive:

Regulatory Balance. A prospective domicile should combine a solid regulatory framework and balanced oversight with the flexibility captives need to meet their evolving risk management challenges.

Operating Flexibility. Make sure the domicile allows the ability to operate as you need it to. Talk with peer captive owners, attend captive conferences and contact experienced captive professionals for feedback to ensure that any prospective domicile can meet your demands.

Legislative Environment. Captives are not static and a domicile's captive statutes shouldn't be, either. Look into the domicile's history of legislative change, regardless of party leadership, to gauge how it might react when risk issues warrant immediate change.

Regulatory Environment. Meet prospective domicile regulators to best learn how they may accommodate your needs over time. Look for full-time captive regulators with robust annual budgets, and avoid those who share their captive duties with other priorities.

Competition among domiciles gives you a wide variety of choices.

Cost. While minimizing operating costs is important, be sure to weigh all non-monetary factors before coming to a conclusion.

Make the Right Choice
Competition among domiciles gives you a wide variety of domicile choices. When you fully understand all that prospective domiciles have to offer, you will make the right decision.

Carefully weigh the advantages and disadvantages of each domicile to find the one that best meshes with your goals. An experienced, independent captive insurance consultant may best help you choose the most appropriate captive domicile for your risk management efforts.

Go to www.townermanagement.com and click **Insights** to find thought leadership papers on this and other relevant subjects.

News Nuggets

The world of captive insurance is constantly changing. These three events brightened the past few months.

Vermont Celebrates Milestone

Thirty years ago, Vermont wrote its first captive insurance laws and saw its first captive formation. Past and current governors and legislators celebrated an anniversary that highlighted the state's non-partisan support that is also an important driver of the local economy. Here's hoping for another 30 successful years.

Tennessee Writes New Laws

Tennessee has a longer U.S. captive history than Vermont, but its captive legislation stalled over time. No longer. The state's House and Senate voted to modernize the state's captive insurance statutes, increasing domestic competition even further.

TMG is 20

Two decades ago, Christopher J.N. Towner had an idea. Today that idea, The Towner Management Group, has grown into a multi-faceted company, featuring its independent captive management firm with a global reach.

The company kicked off year-long festivities with an opening reception in April that included Barbados' Minister of International Business and International Transport, Honorable George Hutson, MP. More festivities are scheduled throughout the year.

Six Reasons to Consider an Independent Captive Manager

Independent captive managers like The Towner Management Group offer their clients more comprehensive services including:

1. Singularity of Focus. Towner Management is independent, so it focuses squarely on the well-being of your captive. Our business is built on the management, administrative, accounting and compliance needs of our clients.

2. Solid Relationships. Why? Because they matter. "It's important to build a level of trust through constant communication with domicile regulators," says Guy Ragosta, partner and CEO of TMG's U.S. operations. "We take the time because it is in our clients' best interests."

3. A Simple Business Model. Managers who are part of larger organizations may feel compelled to offer clients related services or turnkey packages that they and their affiliates provide. Complicated compensation structures can sometimes result in subtle influence.

Independents like Towner Management generally manage and sometimes consult. With a straightforward approach, it is easier to evaluate exactly what you are getting from your manager.

4. Coordination With Related Services. Independents like Towner Management fit well into structures where relationships currently exist with service providers. We have the flexibility and industry credibility to establish and maintain relationships with your service providers.

5. At Towner, We Incorporate the Big Picture. We take the long view, helping captives continuously identify new opportunities to develop their programs. Towner Management has experienced professionals that take our services beyond traditional expectations in captive management. Not all independent managers are the same.

6. Count on More. Towner Management strives to keep abreast of changes affecting your captive. These days, with the escalating pace of changes in your business, your industry, the insurance environment and the global economy as a whole, it is comforting to know that your captive manager is looking out for your best interests.

Take the Captive-centric Approach to Maximize Benefits

In the last few decades as the captive insurance industry has matured, risk management has evolved right beside it. Once a way for only the largest companies with the deepest pockets to temporarily replace unavailable or prohibitively expensive commercial insurance, the captive has become a way of life for a broad range of companies, large and small.

Multiple Benefits

"Captives are the Transformers™ of the risk financing world," says Thomas P. Stokes, Managing Principal of The Towner Management Group (NY) LLC and Consulting Practice Leader for the company. "Captives' ability to adapt to changing conditions combined with evolving risk management techniques

give risk managers a unique way to fine-tune their risk management efforts."

Indeed, captives have become much more than a way of saving money versus buying insurance from commercial markets. Using a captive as a clearinghouse for risk has distinct advantages. It facilitates the evaluation of overall exposure to the enterprise, allowing risk managers to more effectively manage it.

Efficient and Flexible

With captives, risk managers can more efficiently identify and quantify global exposures, control or limit quantifiable risks and determine which risks are best retained by the business. Captives can also

help develop a funding program for retained risks to minimize impact on financial statements, purchase risk transfer for unpredictable and catastrophic risks that can impair a company's viability, report to management how to identify, minimize and eliminate their unique risk, and conserve corporate resources.

Captives are the ultimate risk-organizing and management tool, providing a centralized vehicle to efficiently execute your risk management efforts.

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Captive Insurance Companies are Versatile

by *Thomas P. Stokes*

In the early years of captive development, only the largest companies could justify the dollar commitment of creating a captive insurance company. Back then, companies created captives primarily as a response to specific risk issues caused by severe disruptions in commercial markets such as product liability, workers compensation, medical malpractice and terrorism insurance lines.

Smaller companies faced similar factors, but the capital and operating costs required to utilize captives were prohibitively expensive, especially when only one or two lines of insurance were involved. How times have changed.

Today's captives have evolved into comprehensive risk management vehicles that compete head to head with commercial carriers. Even smaller companies can leverage a lower capital commitment through the use of a variety of new vehicles like small captives, protected cell captives and group participation entities. In fact, new permutations of captive entities are constantly developed to drive down the cost and capital commitment required.

Risk Management Evolves

This evolution in captives coincides with the increasing sophistication of risk managers and loss control techniques. The mysterious black box days of predicting risk are over. Now, risk managers are more willing

to self-insure because they better understand their risks and how they compare to similar companies' risks. More targeted risk management and tax incentives, such as for small insurance companies, make justifying formation and operation of a captive easier.

To make an informed decision, do your homework and seek independent, experienced professionals to help you understand your captive's costs, capital obligations and other requirements.

Tom Stokes is Managing Principal of The Towner Management Group (NY) LLC and Consulting Practice Leader for TMG.

Potential Law Cheers RRGs

The long-awaited introduction of a bill into the U.S. House of Representatives gives domestic risk retention group owners hope that their long nightmare over fluctuating treatment by different states in which they operate will soon be in the past.

The bill, HR 2126, was introduced into the U.S. House of Representatives in early June and referred to the House Committee on Financial Services for further action. The Self-Insurance Institute of America, Inc., the Risk and Insurance Management Society, Inc. and the National Risk Retention Association all have pushed for modernization of the Risk Retention Act of 1986.

Enforcement Mechanism

In particular, RRG proponents have long argued about discriminatory practices against them that are contrary to the federal law that permits this risk transfer entity. The bill, which charges the Director of the Federal Insurance Office with helping to resolve such disputes, could end the uncertainty and legal costs RRGs currently face when their operations are challenged by non-domiciliary state regulators.

"This is a promising start, which can be brought to a satisfying conclusion if the bill is also introduced in the Senate and eventually passed and signed into law," says Len Crouse, Partner with The Towner Management Group, a member of the Government Affairs Committee of the NRRRA. "We'll keep clients abreast of the situation."

Is a Small Captive Insurance Company Right for Your Business?

Small captive insurance companies are creating a good deal of buzz as they become more commonplace. Named after the Internal Revenue Code (IRC) section that enacted them, 831(b) captives are small property/casualty insurance companies with net annual premiums (or, if greater, direct written premiums) of not more than \$1.2 million.

Growing Popularity

In recent years, these captives have accounted for an increasing share of new captive formations. If an 831(b) captive qualifies, underwriting income generated through regular insurance activities is exempt from federal income tax, but investment income remains subject to tax.

Small captives are designed to foster the creation of insurance companies by encouraging the requisite commitment of capital to ease the impact of possible losses. By lowering the threshold cost of captives, smaller companies can enjoy these intrinsic benefits, which help them protect their balance sheets by funding for losses that could otherwise cripple their ability to survive. In their own way, these captives can help support middle-market companies, which experts acknowledge are the bedrock of job growth in this country.

Not for Everyone

Small captives are not a panacea. Not every business will be able to take advantage of the benefits of an 831(b) captive. "As with all issues regarding captives, do your homework and talk to reputable professionals," says Thomas P. Stokes, Managing Principal of The Towner Management Group (NY) LLC and Consulting Practice Leader for TMG. Following are just a few of the issues that must be addressed to determine whether a small captive is right for your business:

- Is my company's risk profile compatible with the risk/reward possibilities of a captive?
- Is my balance sheet strong enough to support the capital and surplus requirements needed to operate a captive?
- Have I conducted a feasibility analysis to evaluate all alternatives?
- Have I investigated all of the costs involved in establishing and maintaining a captive?
- Is my business willing to insure outside risks if necessary?
- Will my organizational structure support a captive?

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