
The

Risk Retention Reporter

Guidelines for Success From a Captive Manager, Consultant, & RRG Director

*Featuring Ted Hall, President CHSI Captive & Insurance Managers, LLC
Director, Physicians Indemnity Risk Retention Group, Inc.*

The single most important priority for a startup, early-stage, or mature RRG is governance, according to Ted Hall, President of CHSI Captive & Insurance Managers, LLC.

He should know. Hall is a CPA, MBA, and widely recognized expert in specialized areas of alternative risk transfer. He has licensed seven RRGs, has two in the pipeline, and is a Director of Physicians Indemnity RRG, Inc., a medical malpractice writer in Florida, Nevada, and Texas. Hall is author of the three-volume *Captive Insurance Manual: The Alternative Market* and numerous scholarly journal articles. He is a former tax partner of the accounting firm, Ernst & Young.

While every RRG Board bears ultimate responsibility for the success or failure of the company, many Boards cede virtual control to a captive manager. This can spell trouble, Hall points out, especially if the manager is responsible for both underwriting and sales/marketing. "There's a potential conflict of interest that can lead to relaxing underwriting standards to gain market share," he warns. "The IBNR (incurred but not reported claims) can take down a small company if strict underwriting standards are not maintained."

Hall does not expect Board members to be insurance experts. However, based on decades working with RRGs, he found that the most successful have Boards who learn enough about the insurance business to measure the captive manager's performance independently.

Board Structure Important

In addition to the nuts-and-bolts of licensing and regulatory compliance, Hall works with founders to develop a business plan and create an organizational structure for effective Board governance. He recommends that Boards create committees that oversee underwriting and claims, finance and audit, marketing, legal, and investments. These committees need to be activated as the RRG grows so Boards can make informed judgments on critical issues. "You can't rely on the captive manager to make decisions for which you as a board member are responsible to the shareholders," he

declares, "but being a hands-on Board member doesn't mean becoming a micro-manager."

As a captive manager, CHSI works with the state of domicile to meet all licensing requirements and continues as the RRG administrator for regulatory compliance. "We recommend independent, professional underwriting and claims organizations to perform these functions under Board supervision independent of marketing," he explains.

The Right Way to Start an RRG

"Many RRGs are started because of market volatility, but that's a weak reason to launch a company," says Hall. He believes that a successful startup must be based

Ted Hall President & CEO

Company: CHSI Captive & Insurance Managers, LLC

Organizational Structure: Limited Liability Corporation that builds and manages Captives and RRGs

Education: BA and MBA, San Jose State University; JD, Golden Gate University School of Law; Certified Public Accountant

Experience: Eleven years at Ernst & Young where he was a Partner focused on property/casualty, life, and captive company taxation issues; 20 years advising, building, and managing RRGs and alternative risk transfer vehicles

Proudest Achievement: "I enjoy each and every assignment and am especially proud of helping to turn around RRGs that have experienced problems. One of my most satisfying roles early on was helping to build MedAmerica Mutual Risk Retention Group, Inc. into one of the most successful, A.M. Best rated medical malpractice writers in the U.S."

What Does CHSI Stand for? "Commitment to Honesty, Service, and Innovation"—a company philosophy that Hall shares.

on three principles—first, the RRG should provide policyholders a new insurance product – not simply a clone of traditional products. Second, the business plan should include a clearly defined concept of governance, management, underwriting, and claims handling. Third, a measurable risk management program is essential.

If the RRG builds on this foundation, it will be prepared to weather the market cycle. An RRG formed simply as a response to traditional markets withdrawing from lines of business – medical malpractice is a frequent example—will lose members as soon as the traditional companies move back into the market with cut-rate pricing that the RRG can't match. Hall points out that many RRGs successfully retain members without trying to compete on price because they offer an equal or superior product, selective underwriting, a commitment to provide stable coverage year in and year out, along with an active risk management program that keeps claims down.

Critical Mass – Why It's Important

Hall defines critical mass as the point when a single major claim will not threaten insolvency. "How to achieve critical mass should be addressed in the business plan when the company is formed," he advises. "I work closely with actuaries in the pricing study to be sure coverage is priced to reserve adequately based on loss history in the line of business," Hall says.

In one case, he explains, a startup medical malpractice RRG excluded high premium/potentially high loss specialties – OB/GYN, neurosurgeon, and emergency room physician – because they aimed to attain critical mass before taking on these specialties. As the RRG builds capital and gains experience with selective underwriting, the Board expects to extend coverage to the excluded specialties. Excess-of-loss reinsurance to protect against unanticipated, major claims is also important, especially for an early stage RRG. In some cases, some RRGs rely on quota-share reinsurance to enable growth.

Incentives to Invest

Many think of an RRG as primarily a means to provide essential coverage to affinity groups that are having difficulty obtaining stable, affordable insurance in the traditional markets. Hall believes the "often overlooked profit motive can be a motivator as well, especially for initial investors." He cites an example of an RRG that was formed by a group of physicians for the usual reasons of controlling their own destiny

through ownership, but also—importantly—with a goal of longer-term profitability and surplus enhancement.

Preferential ownership was granted to the founding investors. Physicians who joined as policyholders made capital contributions that qualified them for dividends as the company grew. The business plan projected dividends and contemplated eventual exit strategies including mergers and acquisitions or an initial public offering that would reward investors while strengthening the company. Hall reports, "The investment potential was an effective selling point members used in promoting the RRG to their peers."

Marketing and Distribution Methods Vary

There isn't a single marketing and product distribution system that fits all RRGs. In developing a business plan, Hall tailors the proposed distribution system to the particular RRG. In the case of an RRG founded by an affinity group, word of mouth can work. Members spread the word among their peers. Where the RRG is affiliated with or endorsed by an industry association or trade group, the insurance can be marketed directly. Often, the most effective distribution system is through committed independent agents and brokers who specialize in the line of business insured.

Number One Industry Legislative Priority

Hall exhorts his industry peers to focus on authorizing RRGs to write commercial property insurance as the single most important legislative priority to spur major expansion of the RRG industry. Working through the National Risk Retention Association and the Self Insurance Institute of America, a lobbying effort needs to be mounted to convince Congress that amending the Liability Risk Retention Act to permit RRGs to write commercial property insurance is in the public interest. Allowing more competition will be good for insurance consumers, Hall believes. "I'm working with a group right now that's just waiting to found an RRG until they can offer commercial property insurance along with the basic liability cover."

Good Governance Counts in the End

In the final analysis, committed oversight by a Board of Directors that learns enough about the insurance business to make informed, independent decisions is the key to success. "I spend a great deal of time with Boards to guide and give them the information they need, but in the end, the Board is responsible for the success of the RRG. Good governance is essential."

*Reprinted from the January 2010 Risk Retention Reporter —
Volume 24, Number 1*