Captives and the Elements of a Successful Approach

Executive Interview with Chris Kopser and Steven Bauman of AXA XL

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AXA XL—the property and casualty and specialty risk division of AXA—provides insurance and risk management products and services for various organizations, including midsize companies and large multinational firms. As a global organization, AXA XL delivers reinsurance solutions to insurance companies worldwide.

Advisen, a Zywave company, sat down with two thought leaders from AXA XL, Chris Kopser (president and chief underwriting officer, primary casualty Americas) and Steven Bauman (global programs and captives regional director, Americas), to discuss captive insurance, including trends in the space and the benefits of working outside a traditional insurance marketplace. With their combined decades of experience and insight into overseeing the growth and development of AXA XL's global insurance programs and captive business, Kopser and Bauman provide unique perspectives on the elements of a well-run group captive approach and ways the space is primed for future growth.

What is a captive?

Bauman: Very simply, a captive insurance company (or captive) is an insurance company owned by the insured. It's a formal way for an insured to self-insure themselves. Typically, captives are domiciled in various states and countries and are, in turn, governed by those regulatory domiciles. Captives are used to organize and retain risks and, over time, reduce a company's total cost of risk. While they are often used as part of an organization's international insurance programs, captives are flexible and can cover a variety of risks—both locally and abroad.

There are several misconceptions I hear when people talk about captives. For one, there's an assumption that captives are not well suited for emerging risks or risks with volatility. But, if you take a measured approach and partner with the right organizations, navigating such risks with a captive can be incredibly rewarding. Another central myth is that people, companies and risk managers often think they're immediately going to save money by using a captive. Captives are a long-term game. There are initial startup costs, and you'll take on more risk in your first years. However, as you build up more risk retention and earn underwriting profit over time, you'll see long-term profitability. It takes time and a forward-thinking vision.

Can you describe the current landscape for captive insurance? What trends are you seeing, and are those trends pushing more organizations toward a group captive approach to managing risk?

Bauman: I started my career in captives and have worked with them for the last 35 years. From my experience, captives are as entrepreneurial and innovative today as they ever have been. Captives have matured for many decades now and, recently, have grown significantly in formation as well as in the breadth of products they offer insureds. Simply put, we're seeing significant increases in captive formation and utilization, making it an exciting time for captives.

Kopser: Insurance pricing spikes from market hardening are a common cause prompting a company or group of companies to explore a captive approach, and we're seeing that a lot right now. From a pricing perspective, pricing is volatile, particularly in lines of business such as commercial auto and cyber. Clients are being asked to take much higher retentions, and capacity is being cut back. The pricing environment is challenging and is a prime example of the market dislocation that drives captive formation and use.

What types of risks are organizations addressing through a group captive approach?

Bauman: There are basically two approaches when it comes to captives. One camp thinks captives should only be utilized for predictable risks. On the other side of that coin, there's a belief that captives can be very effective for emerging risks or risks with volatility. In the latter case, taking a more measured approach is important. That's where partners such as AXA XL can help insureds grow into all their risks.

Kopser: In terms of the lines of business that are often put into a captive, whether it's a single parent or a group, they are workers' compensation, general liability and commercial auto. This is because expected losses in these lines have a high degree of actuarial predictability. But you also have volatile lines where pricing is dislocated. More and more, we get questions from group captives inquiring if we'd be interested in forming a captive around cyber. Put another way, organizations often use captives for predictable risk, but there's also an opportunity where pricing dislocation exists.

What characteristics make an organization a good candidate for a group captive approach?

Bauman: A good candidate for a group captive approach is an insured who has confidence in what they're doing around risk control and risk management. They're going into a captive to take on more risk themselves in a much more formalized manner. These organizations tend to recognize that you need sound risk management and long-term strategy to be a prudent client. They're also not afraid to think outside of the box and take a more innovative approach as they strive to be best-in-class risks. This could involve exploring cutting-edge solutions, such as wearables, as part of their risk management strategy.

What are the elements of a well-run captive?

Kopser: A well-run captive is defined by the parameters they operate under. So, it starts with having strong actuarial support to get a granular view of risks and what the losses are. This approach also helps pinpoint where some attention may be needed to extinguish a negative emerging trend. From a mentality standpoint, the best captives are the ones that are constantly improving the ways they control loss and manage risk. They are open to suggestions and trying new techniques or technologies they could apply to their operations. This is especially important as loss control methods evolve.

What are the benefits of working outside the traditional commercial insurance marketplace through a captive?

Kopser: Let me focus on Group Captives, an area where AXA XL is keenly supportive. When assessing the benefits of a captive approach, it's essential to consider why insureds want to form a group captive. It starts with a like-minded approach to risk. Group members could be in the same (homogeneous) or different industries (heterogeneous). An essential ingredient in successful group captives is enhanced group member focus on safety and loss prevention. These groups seek out additional like-minded risks and prevent admission to companies that don't meet their standards. What you eventually see is as they share loss prevention and safety techniques, group captives' financial performance continues to improve. Since the members are essentially running an insurance company, they ultimately want to beneficially beat the actuarial predictions. When this happens, surplus capital is created. When approved by the regulators, this surplus can be returned to the members in the form of a dividend. To aid in this process, there is a lot of collaboration among the captive members, and there's usually a joint loss control committee that collects and shares loss prevention and safety ideas.

Beyond that, I think having good partnerships between the fronting carrier and the group captive is a mainstay benefit. A captive is a long-term vehicle. Having partners committed to the long game and able to provide additional services and advice that the captive can use to improve their financial and loss performance is a winning combination for the fronting carrier and the insured.

I also think that as captives get more popular, the more they will be considered traditional insurance vehicles. I don't use the phrase "alternative markets" anymore when talking about captives because they've become so prevalent in corporate risk management—it's mainstream now.

What expertise do organizations gain by working with AXA XL for group captive solutions?

Kopser: Firstly, given our extensive scope of operation, AXA XL offers a broad perspective. Our clients often gain insight into trends they may not otherwise have recognized, given the global scale at which AXA XL operates. Secondly, AXA XL provides access to invaluable tools and data analytics to help clients identify actionable insights to reduce their risk. I think you're beginning to see loss reduction technology maturing to a point where you can predict its return on investment with a great degree of certainty. And that's where AXA XL also has a lead position. We work closely with our clients to help them access technology solutions. We have over 40 technology vendors curated for our clients to access through our ecosystem.

Bauman: Many of our clients have multiple lines of business in their captive, and we help with all of them. One of the significant benefits of AXA and AXA XL is the breadth of products we can work with. And it spans all the risks out there—all of our units have the capability of integrating with a captive. So, to me, that's really exciting that we have the capabilities to work with a client with multiple products and can provide the expertise they need to navigate the different challenges that arise across varying sectors of insurance. ●

About AXA XL

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