A Special Reprint from

The Risk Retention Reporter

Best Releases Favorable Report on Captives/RRGs Marketplace

U.S. ratings company **A.M. Best**, in a report released in August, contends that the captive insurance industry, and the risk retention group subsector, are both outperforming the commercial market. The report, titled *U.S. Captives Tightened Margins As Property Losses Spiked in 2012* and written by analysts Steven Chirico and Fred Eslami, concluded that while both premium and net income were flat or fell slightly, surplus grew. Overall, captive companies "tightened margins and used capital more efficiently in 2012."

Interestingly, the captive marketplace "compares extremely favorably with the commercial casualty" market, according to the report. The five-year combined ratio for captives is 92.3, while the commercial market's combined ratio is 103.3. The report also stated that "the captives' operating ratio over the same five-year period is tighter, with the captives generating a five-year operating ratio of 76.0 versus 88.5 for the commercial casualty composite." Best used a subset of more than 200 captive companies to complete its analysis. More than 75% of those captives are currently rated by the company.

The report also included a segment on risk retention groups, based on an analysis of the 40 RRGs rated by A.M. Best at the time of the report. Their analysis found that "RRGs' focused approach has resulted in aggregate operating performance consistently better than that of their peer group of commercial insurers." The report cited RRGs' excellent underwriting expense ratio and combined ratio as reasons for the favorable analysis.

As can be seen in the table on the following page, when RRGs are compared to the captive companies composite and the commercial companies composite, RRG key ratios are consistently better than the other two markets. With the exception of the captive market's underwriting expense and net investments, RRGs outperform both other markets.

The report discusses why RRGs are showing such favorable results, "There are many reasons for the differences, including low retentions, prudent and active management and mitigation of losses, and implementation of robust risk management practices among members. As can be seen, policyholder dividends are relatively larger for RRGs than for commercial insurers. Although it appears to be unfavorable, it is in fact favorable as these dividends are paid to the RRG members. This is clearly a retention tool—a member rewarded for its performance is much more apt to renew its policy. While the aggregate statistics are unavailable, many of the rated RRGs have policyholder retention exceeding 90% annually."

Not all RRGs have or seek a rating from A.M. Best, but according to Steven Chirico, one of the lead analysts on the report, their findings for rated RRGs are reflective of the industry as a whole. In a webinar titled "State of the Captive Insurance Market" and released on the company's website at the beginning of August, Chirico said that after speaking at various industry events, often in conjunction with RRG and captive actuaries, "that [I thought] initially that the rated RRGs were the best RRGs and that they had outsized operating performance, but when I sat with these actuaries, what I basically learned was that the RRG market in general performed almost as well as the 40 Best rated RRGs. RRGs as a group perform better than captives, which perform significantly better than the commercial companies taken as a whole."

Best's section on risk retention groups concludes by stating that while some smaller RRGs formed during the hard market "are likely under the most pressure" and more likely to close operations, that this is not the case for most RRGs. "However, with solid membership trends, outstanding performance, and members' recognition of the benefits of solid risk management, A.M. Best believes the rated segment will continue to thrive."

The complete report and webinar can be found at www.ambest.com.

Key Ratios—RRGs Compared to the Captive and the Commercial Market (2008-2012)

	A.M. Best-Rated RRGs	Captive Composite	Commercial Composite
Loss & Loss Adjustment Expense	53.7	68.1	73
Underwriting Expense	27.5	20.1	30
Combined (before dividends)	81.2	88.2	103
Policyholder dividends	3.9	4.1	0.3
Combined (A/PHD)	85.1	92.3	103.3
Net Investment	17.5	16.4	14.8
Operating	67.6	76	88.5

RISK RETENTION REPORTER — Published by INSURANCE COMMUNICATIONS, P.O. Box 50147, Pasadena, California 91115. (626)796-4972, fax: (626) 796-2363; e-mail: info@rrr.com; URL - http://www.rrr.com **The *Risk Retention Reporter* is published 12 times a year. Subscription Rates: One year: $495.**