# CAUGHT by and in a CAPTIVE

W.E. Love, Jr

[kap-tiv]
noun
1.
a prisoner.
2.
a person who is enslaved or dominated; slave:
*He is the captive of his own fears.*

**"Why don't you folks form a captive?"** I have been asked through the decades. We've looked at this mechanism several times. And let me tell you that I believe we could have made a lot - a whole lot - of money selling, administrating and handling loss in and for a captive. Why not then? Simply, the best insurance companies specializing in insuring truck lines struggle to juggle the complexities of exposure, financial risk and predicting the future. If the true experts have difficulty, what should anyone assume for a much less experienced, self-funded captive? While the set up may vary from captive to captive the answer is always the same: There is no cushion and the risk bearer is the insured! There is not much written about why NOT to join a captive, but if we look into our *crystal ball*, it *will* become a *chain and ball* to captive members and reinsurers.

**Insurance Companies Should Not Try to Run a Truck Line and Truckers Should Not be in the Insurance Business.** Only the very largest, actuarially sophisticated insured's with truly credible, developed, trended losses can predict future loss with reasonable certainty. The rub is that we tend to believe we're going to do better in the future than we have in the past. However, that assumption is not generally supportable. Optimism and planning are best saved for core business aspects rather than a naïve assumption of risk based upon a sales oriented presentation. Irrespective, all losses for the last five years minimum must be fully developed (ask for the captive trend and development factors and compare them with ISO averages), accurate historical and prospective exposure must be calculated. This is an ugly, yet integral process (which always disappoints the trucker) because in the end, loss is statistically ALWAYS (much, much) more than we initially expect! Shifting risk burden to a truck line is dangerous as it is too hard to project and ultimately a capital draining endeavor to the captive members.

**There are only 100 Cents in a Dollar.** Banks don't need footings if there are no bad loans. Insurance Companies don't need surplus if loss and expense are less than premiums. I've served on three bank boards and owned an insurance company. We did our best to underwrite risk and assembled a super staff to do so. Some years we even made a profit. But I cannot imagine operating without surplus IN HAND, even if that was ever allowed. Captives MUST shift risk to the insured members and then purchase what we call "Naïve Reinsurance." Why? Because after commissions, ULTIMATE losses, fees, taxes, reinsurance costs there is no real cost advantage to captive members. Next, captive members must add the tangling of trucking capital for risk collateralization and subtract the lack of both claims expertise and long term conservative investment performance. In the end, if a traditional insurer loses money the trucker moves on without consequence. I've studied at least 20 captive agreements and never seen one that would not come back to bite the members UNLESS losses were LESS than projected.

Traditional, experienced risk bearers will not consider reinsuring a captive unless they are thoroughly convinced that captive members will and MUST make up any capital shortfall.

**A House with Thin Walls.** The best (real) insurers know more about risk than any captive. They know how to handle loss from their *many decades* of doing so. Experienced insurers realize that offering and insisting upon meaningful independent loss control and risk services are extreme advantages to both the trucker and the insurer. The lack of a big brother looking over the shoulder may be enticing to a captive member, but only until the losses occur, develop and, YES, are PAID! *Without the resource* (AKA SURPLUS) of a real insurer, captives must farm out core business functions. Captives use some third party claims service – outsourcing the most important insurer responsibility. Ask for the ten year fully developed gross incurred loss history (This is Schedule P for a REAL Insurance Company) from the TPA handling captive loss. The development of incurred loss (and both allocated and unallocated Loss adjustment expense) over a ten year period is the most complicated, important issue for our insurance industry. “Stop Loss” coverage touted by captives has an initial cost, a maximum coverage provided and a mechanism to collect in the future from Captive members. Each captive has an actuarial study as required, but the historical data is often based upon industry assumptions rather than actual loss experience (Hint: Commercial Auto and Trucking loss develop differently). Do this: Ask to see the study from 10 years ago and compare it with how things actually turned out 10 years later.

**The Best Truck Line: One Without Wheels!** Trucks move. Losses occur in increasingly poor jurisdictions. Captive underwriting ignores, BECAUSE IT HAS NO KNOWLEDGE of the vast exposure history, what a real insurer analyzes in promulgating premium. ISO gives us rates (today they are called loss costs) for big trucks travelling to every metro city in the United States. Captives can deemphasize this underwriting function because the captive member bears the risk of loss! Ultimately the trucker pays for this oversight– unless he parks all his trucks.

**We All Get What We Deserve.** Incompetence**,** self-serving short-sightedness and GREED exist in the truck insurance business as in any other industry. It’s understandable that truckers view insurers often as advisories rather than partners. That said, there are some really excellent, dedicated folks and insurers that I’ve worked with over my career. My simple advice to a truck line is to pick an honest, experienced agent who has a track record that is easy to examine and who will be an involved and proactive advocate! The exact same is true of the underwriting function whether it be a general agency such as ours or the insurance company itself. Regarding captives, I am not going to subject our trucking customers to volatile, long term balance sheet, cash flow and income statement risk. I’m thankful every day for the great risk takers that are the Truckers of our Country. I just don’t like the shift of unknown insurance risk to the trucking industry – ever!

*W. E. Love, Jr. began his insurance career in 1955 and was an active, respected, successful leader within the truck insurance industry. “Dub” passed away in 2013. His favorite mantra was:* ***“Tell the truth – you will not need to remember what you said.”***