Taking Liberty forward

Peter Willitts, president of Liberty International Management, explains how an increasing acceptance of captives in the US is changing the shape of the industry

For the captive sector at large, there seems to be a dichotomy developing between the US and the rest of the world. While European corporations continue to be more reluctant to turn to captive solutions than their US counterparts, jurisdictions that serve the US market have been reaping the benefits.

"US-orientated domiciles have had incredibly strong growth years recently," Peter Willitts, president of Liberty International Management (Liberty), says. "US corporations are driving this industry, and with the exception of Dublin, European domiciles have struggled to capitalise on it. If you look at Luxembourg, the Isle of Man or Guernsey they have suffered some fairly flat years."

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The clarification of the US Internal Revenue Service (IRS) towards captives has undoubtedly been a factor in all this. After a long period of keeping captives in the cold and debating correct levels of premium tax, they have attained much greater acceptance in the US, to the extent that many Bermuda captives are now opting into the US tax system.

Several firms that Liberty manages have already opted for a 9-53 D Election, meaning they are now US taxpayers. "They are actually here for insurance reasons," Willitts points out. "It makes it difficult for US regulators to upset the captive market because most of our clients are actually already US taxpayers."

Until recently Willitts was chief financial officer for Marsh in Bermuda, but was keen to move back into a customer-facing role. Liberty presented him with an opportunity to use his 23 years' experience in the industry to provide new solutions for clients and it is a challenge he is relishing.

Weighing up the competition

One of the main issues is dealing with the advance of onshore domiciles, such as Vermont and South Carolina. Bermuda clearly hasn't been alone in benefiting from the expansion in the captive insurance industry, but Willitts is unsure whether the growth in onshore domiciles may turn out to be a flash in the pan.

"It's difficult to assess if some of these domiciles are going to end up being big players, or whether they are going to reach a certain size and then stop dead," he comments.

Some industry commentators speculate the newer onshore US domiciles' reliance on risk retention groups (RRGs) means they're riding for a fall. This is because RRGs tend to collapse pretty quickly when the market turns soft.

"In a soft market people go out and buy their own best deal, and the group collapses," Willitts explains. "Some of these domiciles that are pushing for recognition may survive, but others will drop out of sight if they don't get critical mass in the near future."

Another interesting issue is tax. Tax incentives were undoubtedly a major reason behind the formation of some of the initial captives, and it would be reasonable to expect these types of structures to multiply in a hard market. Willitts admits he is surprised this has not been the case as yet, although he believes he has an explanation.

"There are two things that have happened," he explains. "First, the IRS has made life a lot easier and clearer and second, companies haven't been making the huge profits that drives the need for those structures. We have seen captive owners looking at insurance problems and what I call profit opportunities, such as extended warranty."

Extended warranty is probably the highest-profile example, but many firms are looking to utilise captives as a profit centre. And this drive forward to utilising alternative structures for an ever-expanding list of activities is putting greater pressure on service providers.

Clients have a raised expectation from of the services they expect from their captive management firms. Bermuda has seen increasing competition between firms, and the race to differentiate will be a crucial one to win.

Bread-and-butter business

One service that makes Liberty stand out from the pack is its commitment to underwriting, an area many broker-owned captive managers are incapable of entering. Willitts sees it as part of the bread-and-butter business of Liberty Mutual, and a facility clients both want and need.

"Some firms will say they can do it, but what they are actually referring to is book underwriting," he points out. "They're not going to seriously underwrite anything, whereas we're prepared to go the whole hog."

"In the early stages of this industry many people got burnt by being somewhat naive in their underwriting for captives. And this was especially true for the broker-owned captive managers who were doing it for clients, as an add-on to the brokerage relationship they already had."

This was more a reflection of the type of business going offshore in the 1970s and 1980s than bad business practice. Bermuda's insurance industry in the 21st century is more accurately represented by higher quality of business and more established underwriting. As the general insurance industry has moved towards utilising ART structures, so the insurance laboratory has found itself pushed to the forefront.

Post 9/11 the offshore insurance sector came into focus and that inevitably led to some fallout for Bermuda.

"The Patriot Act has had quite a large effect on Bermuda," Willitts says. "But that's not because any of the legislation technically affected us, but due to some of the adverse media coverage we have received. "

However, he is confident wiser heads have prevailed. "I don't think anybody has a problem with captives in a business sense," he explains. "Shortly after Enron there was a period where there was a slow-down, but it's back to being acceptable again. California workers' comp, professional liability and medical malpractice are in vogue for captives at the moment and Bermuda is seeing a pick-up in these areas."

In focus: Liberty's expansion plans

Bermuda dominates the offshore insurance market, but in an international industry Liberty International Management (Bermuda) is looking beyond its own shores. Peter Willitts, president of LIM (Bermuda) says his firm is looking forward to a multi-jurisdictional future.

"We are looking to open new offices at some point this year, and our first move is either going to be into Vermont or Cayman," Willitts says. And this onward expansion of the firm is not likely to stop there. He says the firm is putting together a business plan and is talking to its parent, Liberty Mutual, about finalising the details.

Whatever happens, we can expect big things from Liberty in 2004. "When I have spoken to the people at Liberty they have said we need to be in Bermuda, Cayman, Vermont and South Carolina. And looking ahead, there is also the possibility of expanding into Hawaii and Dublin," says Willitts.

Growing in a softening market

It's true to say captives are experiencing a period of sustained growth, but this has been supported to a large extent by the market conditions. But Willitts is not foolish enough to think the hard market can last forever. Several indicators suggest the hard market is on its last legs, and the interesting test for Bermuda will be how it deals with the consequences of a shift in the market cycle.

"Strange to say I've never seen anything other than an onward and upward motion in the alternative market," Willitts says. "Historically something else has always cropped up to drive us onwards. It's certainly not my anticipation there will be any major reversal – what I expect is a slowdown in our growth rate.

Where Bermuda continues to derive business from is impossible to call, but there are certain areas it can capitalise upon.

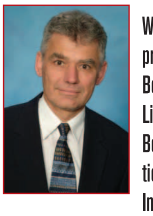
"If you are talking rent-a-captives we believe there is a long way to go and a lot of business to be gained," he points out. "We're recruiting sales-people who do nothing but rent-a-captive sales."

But the focus on rent-a-captive facilities is just part of the general push towards captives, and of Liberty's commitment to the industry. The firm, similar to others, has made a strategic decision to concentrate on growing its captive book of business. And with an increasing proportion of companies looking towards captive solutions, the timing is spot-on.

"Alternative risk transfer is a growing industry and to a certain extent you have to either react to that or get left behind," Willitts says.

And with Liberty's expertise in rent-a-captives, PCCs and underwriting, there is every reason to expect that far from getting left behind, it could be leading from the front in years to come.

Peter Willitts



Willitts is president of Boston-based Liberty Mutual's Bermuda operation, Liberty International Management (Bermuda). Before joining Liberty Mutual, Willitts was based in Bermuda and was chief financial officer for Marsh's captive practice and a director of Sedgwick.