



THE REGULAR PRACTICE OF ROUTINE MAINTENANCE FOR YOUR CAPTIVE

Written By Karrie Hyatt

Just like any business, a captive insurance company needs to undergo routine maintenance. Once a captive is up and running smoothly, owners may think that they can relax, but keeping a captive running optimally is a continual process. Especially during the past year, as the market has gone through rapid changes, many captive owners have had to scramble to keep their captives up-to-date.

Routine maintenance for a captive means taking the time out every year to reevaluate not only how it is operating, but many of its fundamental structures.

According to Anne Marie Towle, Global Captive Solutions Leader with Hylant, said, "Thinking about routine maintenance should be a requirement/best practice for all captive owners. Regular checkups and reviews of policies and procedures for the operations of the captive, including reviewing the business plan on file with your domicile, is very important. Routine maintenance should include a review of all your service providers (including RFPs), your overall strategy, and the domicile.

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Your strategy should include evaluating lines of coverage and leveraging surplus to align with the goals and objectives of owners.”

From a regulatory perspective, Sandy Bigglestone, director of Captive Insurance for the Vermont Department of Financial Regulation, said that “Routine maintenance should include a review of the captive’s business plan to maximize its benefits. Captives play an important role in the overall risk management strategy of their owners and are likely to evolve over time, which may result in amendments to the business plan, for example, to add new lines of business, adjust existing coverage, and add or eliminate reinsurance coverage.”

Periodic operational and strategic reviews should also be conducted with some frequency. Including, “A whole laundry list of items, such as governance practices and structure, use of service providers, claims data/trends, loss control strategies/ educational needs, reserve and pricing adequacy, investment strategy, use of reinsurance, financial performance, capital needs, financial projections/ comparison to actual results, accounting policies and internal controls, industry benchmarking, industry developments, technology developments, and current the regulatory environment,” added Bigglestone.



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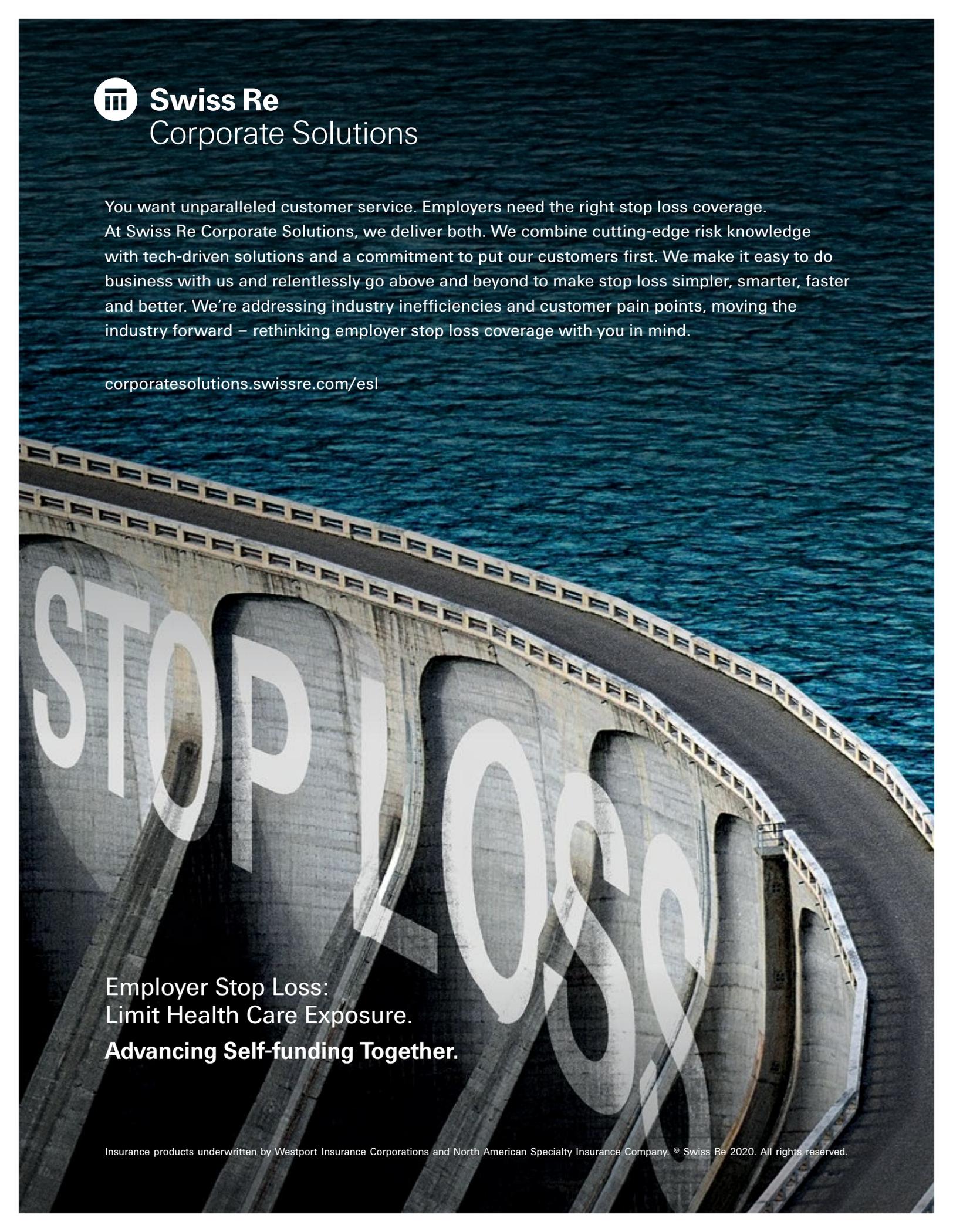
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With so many aspects of the captive to reevaluate, the process can seem daunting. In many ways, it is similar to the work put into starting a captive. Karin Landry, managing partner for Spring Consulting Group, suggests taking the process in steps, such as these:

- Ensure that corporate and captive goals still align with the organization's risk profile
- After identifying changes, evaluate how any changes will impact other parts of the organization
- Build a roadmap for implementation of changes
- Evaluate the captive structure to make sure it meets the needs of new changes
- Consider any regulatory or legislative updates, including the results of court cases affecting captives
- Create a way to measure success for the next evaluation of the captive

Basic routine maintenance should be conducted at least annually to make sure the business plan is accurate and up-to-date with domicile regulators. According to Towle, "It is important to ensure a timely audit and actuarial opinion is completed in addition to review and acceptance of financials."

Bigglestone agrees that basic maintenance should be done annually. "Other issues may be addressed less frequently, as needed, as part of board committee work or special reporting by a service provider or consultant."

Conducting a new feasibility study is a secondary way to make sure that a captive is operating optimally. According to Landry, "We recommend that captive owners reassess, or conduct a 're-feasibility' study every few years. Just like you care for your car, regular check-ups are provided for optimal performance and, in this case, compliance."

The study should check to make sure the captive is operating with the appropriate surplus and has underwriting criteria and lines of coverage which meet the goals and objective of the captive owner.

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Additionally, a feasibility study is recommended when the owner wants to expand coverage in the captive. According to Bigglestone, “When a captive is considering a change in plan of operation to expand or add new lines of coverage, a loss and funding analysis to support the change is often a best practice if not a requirement.”

For Landry, “Typically we recommend every three to five years, but market changes and events like COVID-19 should generate reviews in addition to that timeline. Policy changes or emerging risks might also cause you to speed up your review cadence.”

HAS ROUTINE MAINTENANCE CHANGED DUE TO COVID-19?

The past year has shown how important routine maintenance for captives can be with many companies facing risks that were not adequately covered when the U.S. went into lockdown in March 2020. “The last year has proven that even the best run captives can be thrown for a loop. We had clients who learned about gaps in coverage too late, and need to now revisit policy language and limits. This goes to show that as part of your maintenance—whether as a proactive or reactive measure—you need to be clear on your coverage and policy intricacies,” said Landry.

For many captive owners, the pandemic made maintenance for their captive less routine and more imperative as it revealed gaps in coverage. Towle said, “I have

witnessed many organizations with captives evaluate the captive utilization and how improvements to their overall risk strategy can make the captive core and central to all their risk buying decisions. Captive owners are improving the policies and procedures and ensuring the captive will be able to respond particularly with the hard market conditions of late.”

“I think companies and their consultants have kept an eye on the commercial marketplace for a long time,” said Bigglestone, “And the past year or so has spurred a lot of interest in captives... Existing captive owners are positioned to maximize the benefits, adding a level of certainty in a chaotic environment. New captive owners are also realizing the benefits captives have in the negotiation process with commercial insurers during the hard market renewals.”

Many captives are scurrying to add new lines to their captive since the start of the pandemic. The hard market and coverage gaps that have been seen in the traditional marketplace are steering owners to put more risk into captives.

According to Landry, “This year, we have seen an uptick in including business interruption and medical stop-loss within the captive, for example. [Owners will] need to understand how surplus will be used going forward, which will involve a review of the average cost of capital, retention levels, reinsurance use and taxes, and other factors that an actuary can assist with.”



When asked about what advice she had for captive owners regarding captive upkeep during the COVID-19 crisis, Landry said, "I would say to keep an open mind about the lines that can benefit from being written into your captive. Traditional lines like benefits and P&C remain a good match for a captive, but the pandemic highlighted issues with cyber risk and catastrophic claims, to name a couple, and a captive can be used to address these. Rising costs are causing more employers to engage in voluntary benefits, which can also work well in a captive. I would also say that a captive program should be reasonably nimble in that it's feasible to make relatively quick changes. Overall, the depths of how your captive can perform is likely bigger than you thought."

For Bigglestone, right now it's reasonable to put aside extra or non-routine maintenance in order to prioritize the captive's resources until the current economic difficulties have passed. "The pandemic has caused extreme uncertainty for many companies, operationally and financially. As a regulator, I like to see that a captive owner has taken the time to assess the current and prospective impacts the pandemic has had on its business and how they may impact the captive's results. A captive owner should leverage its service providers and other resources for any upkeep needs. A secondary benefit of doing so will help a captive owner assess its service providers' value."

"I would encourage captive owners to review their captive strategy and how it aligns with the parent company's strategy," said Towle. "Alignment and implementing appropriate measures can have an incredible impact to both the short and long-term utilization of the captive. Double checking the business plan on file, ensuring the captive is in compliance, and regularly updating the captive manager and domicile is instrumental for the long-term success of a captive program." ■

Karrie Hyatt is a freelance writer who has been involved in the captive industry for more than ten years. More information about her work can be found at: www.karriehyatt.com.

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