

Ask Yourself: Who's Guiding My Captive's Future?

By Thomas P. Stokes

Chances are, many captive owners won't be comfortable with the answer. Captives, especially those that have been in operation for a number of years, are likely not providing owners with the most bang for their buck in this ever-changing global economy.

Take A Closer Look

Like a vehicle inspection station makes sure your car is at least minimally safe according state guidelines, a captive management company only ensures that the captive operates functionally according to fiduciary, regulatory, accounting and administrative standards. While these services are vital, they do not ensure that a captive is positioned to operate at peak efficiency in the future.

Contrary to popular belief, most captive managers don't help you investigate and develop new and innovative ways to leverage your captive to keep up with the changes in your business and the world around you – that's just not what they are paid to do. This misconception can cause your captive to miss valuable cost-saving opportunities.

And if risk managers cannot demonstrate the captive's continuing utility, the capital invested could be redirected elsewhere. In extreme cases, your company's lack of awareness of your captive's true value can result in rash judgments and possibly cost your captive its very existence.

Your Manager's Role

To be clear, your captive management company has a set of key responsibilities, as outlined in the contract. Typically, these responsibilities vary only slightly from one client to the next. A manager's fundamental role is keeping the books and records, reporting results to the parent company and regulators, managing the annual audit and otherwise ensuring that the captive meets all of the solvency and reporting requirements imposed by its domicile.

In addition, managers prepare the board book for and host the required annual meetings. Management firms also will collect and record premiums, pay claims and reconcile periodic banking statements.

Most captive management firms do a pretty good job of providing these basics. Captive management is a competitive business and managers wouldn't be around for long if they weren't competent. But the stark reality is that, in most cases, captive managers will not suggest ways to keep your captive operating at peak performance because it is not what they are paid to do, nor is it within their skill set.

The older your captive is —five, ten or more years – the more likely the reasons for its creation and the people behind its creation have changed. Even if needs and people remain constant, the outside world has changed – dramatically. This is when a focus on the future – and how your captive best adapts to an environment of constant change – becomes vital. The obvious course of action is to find a qualified captive development consultant and set specific goals for charting the course of your captive. This is when asking the right questions for your periodic review becomes crucial.

The best way to ensure that your captive meets minimum standards **and** runs at optimum levels is with a detailed annual review. Like everyone else these days, you probably have myriad other responsibilities and don't have the time

or the resources to make this kind of review a priority. You might assume that your insurance broker is always considering how to save you money by considering your captive in the mix, but it helps to remind yourself of the broker's primary objective: to sell you insurance for a commission. You need someone with the right experience in your corner.

Complete The Picture

Put yourself in the driver's seat by partnering with a qualified alternative risk consultant and making it a priority to institutionalize an annual captive performance review. Here are some of the questions to consider as you move forward with your search:

When consulting with an independent alternative risk consultant, it is critical to evaluate this professional's capabilities in response to some key questions to help you determine whether you have the right match for your needs:

Evaluate the consultant's responses to and experiences with the following:

- **Are the captive's benefits fully realized?** If your captive was established years ago, you need to consider this question in light of changes that have occurred since then. Benefits you hope to achieve may include cost-savings versus buying traditional insurance, tighter risk controls and possible tax advantages.
- **Have changing external factors had an impact on your captive's operations?** Whether positive or negative, what, if any, steps were taken to mitigate them? One only needs to look at the tax and regulatory environment to understand the importance of planning for all possible scenarios.
- **What internal factors have had an impact on your captive?** Managers and executives come and go, sometimes changing an organization's risk appetite and approach to business. Have new risk managers, other changes in personnel, acquisitions, new product lines or other new developments put your organization in a different place than when the captive was first established? In particular, changing financial fortunes can have a significant impact on senior management's perception of the captive.
- **How have changes in the traditional insurance market affected your company and what does it mean to your coverage?** Affordable and available insurance coverage acquired through commercial brokers can become unaffordable and unavailable during a hard market or a particular line of coverage's poor experience. History tells us insurance rates can and will increase, and some lines will at least temporarily disappear from the market when capacity becomes limited. Just because your coverage is here today doesn't mean it will be there tomorrow. By the same token, soft markets could provide opportunities to save significantly while achieving risk transfer. In this environment, the captive could be insuring too much risk.
- **Is management fully informed regarding the exposures covered by the captive?** If not, your company could be exposed to liability. Gaps in coverage can occur as well as entire layers of risk open to direct exposure to the company's balance sheet unless the captive program is actively incorporated into the commercial program renewal process.
- **Are there new reinsurance opportunities available?** The reinsurance market is constantly experiencing capacity issues. Rather than wait until lack of capacity trickles down to the direct market, knowing your options allows you to proactively manage and finance your risk.

- **Do other captive owners use different techniques to enhance their captives' benefits?** Comparing risk management techniques among similar organizations can ensure that you don't miss new developments that would benefit your captive. *Reinventing the wheel* can be both time-consuming and expensive.
- **What new opportunities exist to utilize the captive to the company's full advantage?** Risk managers recently have shown a renewed interest in using their captives to fund employee healthcare benefits, for example. New, non-traditional ways to use a captive to protect against cyber-risk, geopolitical exposures, terrorism and myriad other risks are being developed and will become de rigueur. To take full advantage of your captive, you need to be aware of the opportunities.

The Independent Review

The captive review process should work in concert with your current captive management firm and should **NOT** be viewed as an indictment of your captive manager's performance. This type of review does not, as a rule, encompass captive management techniques.

The Towner Management Group champions the independent annual developmental review approach for captives, regardless of the captive management company. Our consultative services are offered in response to the continuing sophistication of risk managers and the development of loss prevention techniques.

Risk managers have an awesome responsibility to identify and minimize the dizzying array of risks that challenge the viability of their enterprises. More and more, companies are identifying captives as the tool of choice to channel, fund and manage these risks — a *captive-centric* approach. Towner Management helps companies thrive using this approach.

Conclusion

Like risk, opportunities can only be acted upon when identified and understood. Identifying these opportunities can only be accomplished through a regular review of your captive operations. At the outset, examine the reasons for its existence and the current risk management and insurance climate. Then, identify and quantify your business risks and evaluate the use of your captive in mitigating them in a rapidly changing environment.

An experienced, independent captive insurance consultant is best suited to partner with you to conduct your captive review. Together, you will identify new opportunities to make the captive work for you. Reviews need not be time-consuming or expensive, but they should be performed regularly.

Tom Stokes is Managing Principal of The Towner Management Group (NY) LLC and Consulting Practice Leader for TMG. A veteran of more than two decades in the captive and insurance industries, Tom previously held thought leadership positions with the world's largest public accounting firms and captive consultants and managers, including KPMG, PwC, Aon and Willis.

To learn more about captives and the annual performance review, contact Tom in our New York office at (203) 695-2102 or tom.stokes@townermanagement.com. The Towner Management Group is an independent, full-service captive insurance and international business entity management company with a multi-domicile reach, dedicated to providing our clients with the continued development of alternative risk solutions to meet their diverse needs.