

**Best Practices Primer – Captive Insurance Companies**  
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Best practices guidelines help assure effective captive management and staff training. This outline includes the major components of a best practice compliant captive.

In today's increasing regulatory environment, a higher degree of structure, control and expertise in managing the day-to-day operations of a captive is required. Increasing regulatory oversight and additional mandatory disclosures are the trend in both the US and abroad.<sup>1</sup> Reviewing your corporate governance policies and procedures and implementing best practices is indicated.

A periodic independent outside best practice performance review is the best policy. The cost of such a review depends upon the scope and expected deliverables which should be addressed in the engagement agreement.

### **Business Plan**

Every captive should adopt a comprehensive set of business operating documents. These would include the business plan and all related procedure and policy documents.

The business plan is merely the introductory document usually needed as part of applying with the selected domicile's insurance department for an insurance company license. Each domicile will have guidelines and specific requirements.

The business plan should determine and address needed outside resources.

Decisions made while developing the business plan should include:

- Organizational structure
- Domicile selection
- Ownership composition
- Management and board composition
- Committee scope and composition
- Risk assessment, measurement and management members
- Policy scope and documentation
- Banking and investment management programs
- Accounting, financial and tax compliance members

Care should be taken to define the specific human resource, other systems and quality controls needed to efficiently manage, benchmark, collect, report and review transaction data whether required or not by the domicile in your application documentation.

The business plan and exhibit should address resources and procedures needed to create and maintain:

- insurance policies and schedules
- premium invoicing and collection
- banking activity
- investment activity
- accounting functions
- financial statement preparation, review and reporting
- regulatory filings and compliance, including all applicable tax returns
- and overall organizational management (See Corporate Governance below).

Once all of the above has been completed, detailed financial projections should be prepared and updated annually to benchmark financial performance.

### **Management Commitment**

Creating and operating a captive has long-term business implications. Management needs to make an appropriate commitment to the venture and maintaining sound business practices. Once a captive is created, it may not be dissolved or terminated without regulatory approval and oversight since the policy holders and unrelated third party prospective claimants have vested interests to consider and protect.

### **Corporate Governance**

Required administrative management to assure fairness, accountability, transparency and discipline fall within the realm of corporate governance. Sufficient experience to operate an insurance business should be reflected within the experience of the board of directors. As needed, outside directors should be retained. An independent director and one or more management committees are recommended. Each management committee could also include qualified independent members whether voting or not.

All captives should strive to have the following even if not required by the regulating domicile:

- a formal board of directors serving designated terms;
- a designated chairman of the board;
- elected officers or managers;
- the equivalent of corporate articles, by-laws and operating agreements;
- Up to date corporate book including meeting minutes (of the board and committees);
- Formal and adopted policies and procedures, including frequency of required meetings;
- Board decisions and deliberations must be documented in well maintained minutes.;
- Continuing education should be provided board members;
- An employee manual and handbook;
- Periodic personnel and service provider performance reviews;<sup>2</sup>
- Periodic testing of internal controls should be part of the policies and procedures;
- Committees should be formed and given primary responsibility for underwriting and risk management, finance and investment activity, and audit and regulatory compliance;
- Periodic related committee reports should be prepared for submission to the board;

A good set of corporate governance guidelines would include board operations manuals, financial controls and protocols, and investment strategy policies (including a conflict of interest policy).

### **Outside Service Provider Management**

The board and management of every captive must designate someone responsible for managing the various outside service providers needed to form and operate a captive including:

- Lawyers
- Auditors
- Actuaries
- Management Firm
- Independent Directors
- Resident Director
- Investment Advisors/Managers
- Tax Professionals
- Fronting and Reinsurance Associates
- Insurance Brokers

### **Regulatory Compliance**

Captive operations must not only meet owner objectives, but must comply with industry and domicile rules and regulations.

Captive management should maintain calendar based checklists of all required regulatory requirements to share with the board and effected committees. Non-compliance events should be documented and timely corrected. These checklists should address licensing requirements, insurance policy periods and renewal requirements, financial reporting requirements, capital and solvency requirements, audit and tax compliance requirements, other regulatory filings, and all time sensitive matters impacting third parties.

Captive management staff training manuals are recommended so staff turn-over or absences does not cause reporting compliance issues. Every captive is unique, so every captive should develop detailed staff role, responsibility and training manuals complete with daily, monthly, quarterly and annual activity checklists and guidelines.

Each captive should also have guidelines on what activity changes invoke additional regulatory reporting requirements such as changes in directors, officers, managers, actuaries, auditors, insurance products offered, and investment policy.

Solvency and financial strength are key issues for regulatory agencies due to their consumer protection responsibility. Captive management must be familiar with and utilize procedures and tests to monitor performance and strength ratios commonly used in the insurance industry. Maintenance of the following ratios for board consideration are recommended:

- Premium to surplus ratios
- Expense ratios

- Loss ratios
- Investment income ratios
- Reserves to surplus ratios
- Retention to surplus ratios

### **Communication and Document Storage Protocols**

Ongoing communication between the board, management, service providers and regulators should be maintained. Electronic and physical copies of all operational data should be maintained for the life of the captive, and for the period of years required after wind-up. Information technology should be fully utilized for easy access, back-up and secure virtual storage of records.

### ***References:***

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