Working With Your Captive Manager

By Martin Eveleigh

For any owner of a captive insurance company, the nature of the relationship with the captive manager can have a very significant impact on the success of the captive and the benefits that the owner erives from having a captive. It is, after all, the captive manager with whom the owner will be dealing most often and to whom he will turn with questions about the operation of the captive and what opportunities there may be to get better use out of the captive. So, how best to work with the captive manager?

What to expect of the captive manager

The captive's board or the captive's owners (in the case of smaller captives, generally one and the same) must know what to expect of the captive manager, whose primary role is to provide and apply professional insurance expertise to all aspects of the running of the captive.

The captive's owner rarely has an insurance background and insurance is not his core business. Running an insurance company – a regulated entity – particularly insurance company accounting, is quite different from running almost any other type of company. For example, an insurance company's income statement will record changes in unearned premium and show total unearned premium as a balance sheet liability. So too with loss reserves, which include case reserves and IBNR (incurred but not reported losses), the valuation of which requires professional judgement and actuarial opinion.

Then, annual statutory filings will need to be made according to the specific form proscribed by the domicile regulator, which may bring up the question of the difference between GAAP and statutory accounts. All of that on the accounting side of the house; we have not even spoken about underwriting, claims adjudication or reinsurance.

Clearly a specialist is needed. This specialist, the captive manager, is engaged by the captive and is accountable to the directors of the captive.

The need for a captive manager does not arise solely from the need for the peculiar professional expertise that the captive's owner lacks. In almost every case, the appointment of a captive manager also satisfies a regulatory requirement. Insurance regulators want to know that any insurance company that they license, captive or otherwise, is managed by people with relevant professional knowledge and experience. To this end, most captive domiciles license captive managers and only licensed managers may manage captives in the domicile.

Whether implied by the license or statutorily imposed, the captive manager has a secondary role as the eyes and ears of the regulator. It is important for the captive's board to understand this element of a captive manager's responsibilities, which may appear to conflict with its accountability to the captive's

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board and its client relationship with the captive itself.

The captive has an obligation to comply with the laws and regulations of its domicile. The manager has an obligation to manage the captive consistent with that. He also has an obligation to report non-compliance to the regulator, especially where there is a risk to the solvency of the captive.

Responsibilities of the captive/ captive owner

A captive insurance company is a regulated entity. As such, acting through its directors (and ultimately its owner) it has a responsibility to comply with the laws and regulations of its domicile. Of course, any business owner is aware of the need for his business to act lawfully in the broad sense, but insurance laws and regulations impose specific obligations, of which a captive's owners and directors might not intuitively be aware. In fact, it is hard to overstate the importance of regulatory compliance. Yet most, if not all, captive managers will have seen funds withdrawn from the captive as dividends or loans without any prior regulatory approval, or indeed without any prior advice to or consultation with the insurance manager. They will also have seen new directors appointed and perhaps shares transferred without prior approval.

These infractions may not necessarily have had any adverse effect on the captive. Indeed, it is highly likely, in most cases, that had approval been sought, it would have been granted. But how did the regulatory breach arise in the first place? Probably most often through ignorance or forgetfulness.

Neither captive manager nor captive owner can be sure of finding a foolproof way of eradicating these two evils but the captive owner, who takes his obligations seriously and wishes to learn, has the right to expect that the captive manager will educate him as to what those obligations are. Similarly, the captive manager, who informs his client and makes efforts to keep him informed and alive to his obligations, has the right to expect that his client will, at the very least, ask before doing anything without the manager's knowledge. This awareness, this communication and this sense of mutual obligation (as well as the shared obligation towards the regulator) goes to the heart of the relationship between captive owner and captive manager.

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While the captive owner has certain responsibilities, it is part of the job of the captive manager to help him meet them. To this end, a captive owner's manual can go a long way. Prepared by the captive manager as guidance for all its clients, the manual should provide the captive owner with a clear sense of how the captive will be run, who will do what, what the captive's regulatory obligations are and the responsibilities of the directors of the captive. It should also be clear on communication between manager and owner.

Beyond the initial provision of an owner's manual, the captive manager must ensure that the owner is kept up to date about regulatory matters and, in particular, any changes. How this is done is likely to vary depending on the size of the captive and its level of activity as well as on the nature of whatever it is the manager has to communicate to the client.

Of course, communication is a two way street. It is so much easier for a manager to communicate effectively (and enthusiastically!) with a receptive or even inquisitive client. In the same way, the captive manager should be delighted by clients who demonstrate a consistent, regular interest in the operation of their captive and its potential to benefit their core business. He should give his time to them generously.

Choice of Captive Manager

The captive owner who wants to get the most out his captive will need to engage a captive manager that has, in addition to a first class client service team, the knowledge, experience and ability to see the big picture and to deliver great ideas and solutions. Above all, the captive owner needs to engage a captive manager with whom he feels he can work. Captives change managers relatively rarely. The relationship can, therefore, be long and often close.

So, when choosing a firm to act as captive manager, the owner should look beyond the basic questions of "Can they do the job?" and go deeper.

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It is important to take a look at the background of the captive manager's key staff. Do the accounting staff have an

insurance background? Have they worked for major carriers or brokers and does their experience go beyond captives? The same question can be asked in relation to senior management, relationship managers, underwriting staff, etc. Does the firm have broad knowledge of insurance and reinsurance? It should.

It is also worth considering the extent of the captive manager's captive experience. There is a world of difference between a manager that manages S.831(b) enterprise risk captives in one jurisdiction and a manager that works in multiple jurisdictions servicing group captives, agency captives, enterprise risk captives and larger single parent captives. This is not to say that one is necessarily better than the other, but the captive owner must be aware of the difference in order to make an informed choice and to have the best prospect of a long-term, fruitful, collaborative relationship with the manager.

For many captive owners, particularly owners of larger captives, the question of whether to accept the bundled captive management services of their insurance broker's captive management arm can be a difficult one. I am in favour of unbundling; in other words, engaging the services of an independent captive manager. Of course, as an independent manager , I would think that, wouldn't I?

In favour of the bundled approach, one could say that different departments within the same organization will work more effectively and harmoniously together to deliver results for the client. On the other hand, all of the expertise available from a major broker is available on an unbundled basis (i.e. the client can pick and choose the service provider of his choice for each required function) and similar expertise is readily available from other, perhaps more specialized firms.

There is a lot to be said for harmony (if, indeed, it exists within large firms) but there is at least as much to be said for a little creative tension and the notion that two heads are better than one.

Conclusion

Good communication, mutual respect and a willingness to share ideas and information are all essential to getting the most out of a captive manager. It should be obvious that the foundation for these requirements is in the early stages of the relationship, where the choice of manager is made and when mutual expectations are set.

Rushing the process of making the right choice, perhaps simply by not talking enough, can lead to frustration on both sides and discord that may be challenging to repair.

If the right choice has been made and these values are consistently demonstrated, the captive manager can deliver enormous value to the owner, and both can enjoy a long and fruitful relationship.

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