

CAPTIVE BEST PRACTICES GUIDELINES

VOLUME 2: UTILIZING SERVICE PROVIDERS

PRODUCED BY

CICA
CAPTIVE INSURANCE COMPANIES ASSOCIATION

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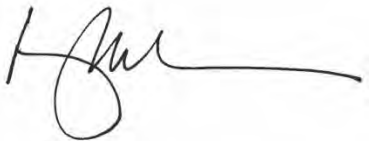
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WELCOME TO CICA'S BEST PRACTICE GUIDELINES FOR UTILIZING CAPTIVE SERVICE PROVIDERS!

On behalf of the Board of Directors, I would like to express my personal thanks to all of those who made this effort possible. As you might guess, this took many hours of planning, conference calls, e-mails, writing, and re-writing, throughout 2009. As you will see in the following pages, we recruited some of the best and brightest minds in the captive community for this project. Thank you all for your contribution to creating the initial service providers' best practices guidelines.

While we hope every captive practitioner will benefit from these guidelines, prospective captive owners should use these best practices as their guide posts in the world of captives.

We are proud of the final result and are confident that captive owners will find it as an important resource for the establishment and management of their captives and other formal self-insurance vehicles.

A handwritten signature in black ink, appearing to read 'K. Landry', with a long horizontal flourish extending to the right.

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I. INTRODUCTION

In 2007, the Captive Insurance Companies Association (CICA) formed an advisory committee to develop a set of Captive Best Practices Guidelines. The guidelines were created through a process of soliciting opinions from a team of captive owners, regulators and representatives of the captive marketplace. The project was an important initiative towards a long term process of continuous improvement that we hope will become required reading within the captive community. This first phase of the CICA Best Practice Guidelines focused on three specific areas: business alignment, corporate governance, and regulatory compliance.

After the success of the initial Best Practices Guidelines, and based on feedback from CICA members and conference attendees, CICA decided to create a more detailed set of operational best practice guidelines focused on service providers, including captive managers, consultants, actuaries, auditors, and lawyers. These new guidelines provide captive owners with best practice guidelines describing what they should expect from their service providers.

Since the needs of captive owners vary, these best practices are intended to serve as guidelines for the various stages of captive development and maturation for a variety of captive types. They need to be considered in light of each particular captive's facts, circumstances and objectives, since each captive is unique. These guidelines should not be viewed as prescriptive. They should serve as guiding principles for captive owners and members as they develop and manage their captive programs. They should not be viewed as a checklist for forming and operating a captive. Additionally, this document is in a stage of continuous improvement and we welcome any comments from readers.

In some instances, our recommendations may conflict with a domicile's specific legislation. Where there is a conflict, the domicile legislation and requirements should be followed. Furthermore, best practices require the service provider to adhere at a minimum to their own professional standards of practice, as appropriate.

Captive owners should be aware that many service providers may offer the functions outlined in this document and that the fees paid by captive owners for those services will vary not only based upon the service requested, but also upon the qualifications of the person doing the work and many other factors. Since the intent of the document is to provide guidelines for operational areas, it is important that captive owners do their own due diligence and select captive service providers that best meet their needs.

In developing this set of best practices, we used a process with multiple working groups. This latest best practices initiative involves advisory groups of captive owners and captive regulators working in parallel with four groups representing service providers – captive managers, actuaries/consultants, auditors and attorneys. The process began with the owners and regulators suggesting best practice ideas and key issues to which the service provider groups would respond.

We organized these best practices around the four life stages of a typical captive:

Captive Life Stage	Definition
Pre-feasibility	Process prior to the decision to establish a captive insurance company
Feasibility and Formation	Process involved in establishing a captive insurance company
Management	Day to day activities in operation of a captive insurance company
Closing a Captive	Steps towards discontinuation of a captive insurance company

For the feasibility and formation process, captive owners, to avoid unnecessary cost and duplication of effort, should try to delineate responsibilities between service providers such as the actuary, consultant and the captive manager. This paper will serve as a good starting point in making these determinations.

Additionally, where applicable, differences in best practice may vary based on the type of captive (pure, group, risk retention group (RRG), segregated cell) and its location (onshore versus offshore domiciles).

Processes and Controls Checklist

When establishing and maintaining a captive insurance company, there are many important factors that must be addressed. While some of these can be performed by multiple service providers, the captive owner should decide ahead of time which of the qualified service providers is responsible in order to avoid overlaps and ensure that all tasks are covered. Below is a high level overview of who performs these services by captive life cycle in order to give a sense of where the overlap occurs. In each service provider section, a more detailed description of the tasks is provided.

Task	Captive Manager	Actuary/ Consultant	Auditor	Attorney
Pre-Feasibility				
Strategic review and risk analysis		X		X
Tax, legal and regulatory pre-formation advice		X		X
Feasibility and Formation				
Strategic advice on formation	X	X		X
Information flow	X	X		
Documentation development	X	X		X
Feasibility study		X		X
Management				
Information flow between service providers	X	X		
Attend meetings	X	X	X	X
Financial reporting	X	X	X	
Contract advice		X		X
Regulatory compliance	X	X		X
Administrative tasks	X			
Audit report			X	
Data security	X	X	X	X
Stewardship report	X	X	X	X
Board meeting documents	X	X	X	X
Payment flow with reinsurers	X			
Claims management	X	X		
Closing a Captive				
Information flow to regulator	X			X
Exit strategy	X	X		
Asset/liability review		X		
Loss reserves certification		X		
Legal requirements				X

II. BEST PRACTICES FOR ANY SERVICE PROVIDER

The captive owners and regulators concluded that certain best practices should apply to all service providers. These best practices describe what captive owners should be able to expect from service providers related to quality deliverables, appropriate levels of performance, and more effective relationships between service providers, captive owners, and regulators.

A. MANAGING RELATIONSHIPS

Service providers should approach each relationship as a long-term commitment and follow these guidelines in their relationships with captive owners and regulators:

- Maintain a “sense of urgency” in providing services
- Provide innovative and creative input where appropriate
- Probe for understanding when captive owners ask for advice or services
 - Challenge the captive owner’s assumptions, if appropriate
 - Ask for and be receptive to feedback
- Clarify the scope of services so the owner can have confidence that all needs are being addressed
- Fairly represent their expertise with regards to captives, insurance, reinsurance and alternative risk transfer mechanisms allowing the captive owner to evaluate each service provider and their capabilities in the following areas:
 - Knowledge of and experience with specific domicile
 - Experience by line of business
 - Property & casualty
 - Benefits
 - Experience with different captive types, including non-profit versus for-profit scenarios, if applicable
 - Pure (Single-parent)
 - Group
 - RRG
 - Protected cell / Rent-a-Captive
 - Knowledge of specific product line and industry (e.g. medical malpractice, warranty coverage, trucking, medical liability, life, disability, medical stop loss, pensions, etc.)
 - Understanding of specific business risks and industry being analyzed, if applicable
- Know the captive owner(s) and perform on their behalf
 - View from perspective of captive owner
 - Consistently mirror captive owner’s values and beliefs
 - Understand the business and culture and captive owner’s expectations of performance for the captive
 - Understand personalities, strengths and weaknesses of the captive owner and staff
 - Understand captive owner’s motivations and ensure they are consistent with the statute and spirit of the regulations of proposed domicile
- Establish minimum standards of communication with the captive owner and all other service providers relative to the timing of activities, meeting documentation, etc.
 - Communicate to senior leaders/partners of the captive owner and adequately explain the risks

involved in the venture and roles and responsibilities

- Maintain current service agreement that documents servicing parameters, term of contract and associated fees

B. SERVICING GUIDELINES

All service providers should perform the following basic services throughout the term of their contract as requested by the captive owner:

- Meet with captive owner:
 - Determine scope and price of work
 - Understand your client’s needs
 - Establish timeline and key deliverables
- Provide expert assistance and advice to captive owners
 - Anticipate where help will be needed before being asked
 - Speak proficiently to underwriters about current issues within businesses/programs
 - Share best practices with captive owners
- Deliver on promises by meeting/exceeding deadlines, and communicating when and how plans need to change
- Document all processes and procedures
 - Maintain list of open items and actively manage them
 - Provide (or contribute to) highly detailed, customized, work checklists for every process
- Meet needs and wants of captive owner through state-of-the-art technology, including providing secure electronic methods for managing data
- Hold regular meetings as agreed with captive owners
- Remain current relative to new rules and regulations within the relevant captive domiciles and industry
 - Make sure that all employees and senior management/partners hold applicable licenses and have necessary qualifications
- Work product that has no errors
- Provide periodic updates to captive owner of pertinent changes
- Give guidance to the captive owner on new items that effect them
- Make captive owner aware of opportunities for improvement of existing processes

C. CREATING DELIVERABLES

Most service provider roles include the production of deliverables, either as an initial step to establishing the captive, or on a regular basis (for example, annually). All service provider deliverables should meet the following guidelines:

- Agree upon key deliverables and metrics between captive owner and service provider
- Develop metrics to address both the quality and timing of deliverables
- Identify who is responsible for the deliverable at both service provider and captive owner level
- Maintain documentation in an accessible and understandable format for captive owners

- Have a disaster recovery/data back-up plan should be in place for all deliverables

Service provider deliverables can include:

- Benchmarking the program versus others based on available knowledge/data
- Focus areas of focus for the upcoming year(s)
- Scope of service provider fees – what is included and what is not

III. SPECIFIC SERVICE PROVIDER GUIDELINES

A. ACTUARY/CONSULTANT

PRE-FEASIBILITY

Selecting a Consultant

There are many insurance brokers and generalist consultants that claim to understand how to analyze a prospect's suitability for a captive and to have the ability to guide the prospect through the implementation process. As with all specialized service providers, some brokers and consultants are quite qualified to perform these services, yet many others only purport to be qualified. First, captive consultants should be independent inasmuch as their advice and guidance is not driven by any actual or perceived vested interest.

For example, many brokers have extensive captive knowledge and experience, but the prospect must understand that the broker's ultimate goal is usually to capture all of their business, including the placement of the excess insurance/reinsurance, and possibly managing the captive. Purely independent consultants are usually compensated based on the work they perform for their clients and not on any future revenue expectations. Consultants and brokers who offer to "throw in" the feasibility study for free as an incentive to form a captive should be avoided unless the decision to form the captive is a foregone conclusion.

Second, experienced captive consultants should be able to provide at least three quality references. A lack of references indicates a lack of any meaningful captive experience. Third, the consultant must be able to demonstrate competency through the proposal process. Proposals should include an overview of the feasibility process, the important study topics, data requirements, a detailed timeline, and a formal process for selecting the other professional service providers (attorney, captive manager, actuary, & auditor). Worthwhile consultants usually have established relationships with many different captive service providers, including the various domicile regulators. Fourth, competent captive consultants should be conversant in the financial aspects of the captive. Consultants should be able to create detailed pro forma financial statements, provide guidance relative to the various solvency ratios, and be able to discuss the nuances of capital and surplus. Finally, a captive consultant should be able to discuss the various ownership structures available from pure captives to affinity groups and associations.

Selecting an Actuary

Selecting an actuary is easier than selecting a consultant because of the credentialing requirements. Like consultants, actuaries should be able to demonstrate considerable experience with captive work, and ideally should also be independent of any other vested interest or agenda. Most importantly, however, the actuary must be either a fellow or an associate of the appropriate actuarial society. The actuary's primary function is to perform detailed loss analyses; primarily reserve adequacy and loss projections.

Competent actuaries are also capable of performing a variety of tasks, including feasibility work and financial statements. As such, it is important, early in the process, to clearly define that which the consultant should perform and the work expected from the actuary. Some consultants prefer to have the actuary focus solely on the loss analysis while others welcome any other expertise the actuary may offer.

Strategic Review and Risk Analysis

A strategic review and risk analysis to determine the viability of any program should:

- Review qualitative and quantitative reasons whether or not a captive makes good economic and business sense
- Strategically review the captive owner’s needs, circumstances, structure and risk appetite
- Discuss potential regulatory, tax, legal, investment and financial issues
- At a high level, analyze the costs and benefits of establishing a captive
- Evaluate enterprise risk management (ERM) considerations including non-traditional risks that could be placed in a captive (i.e. employee benefits, property & casualty, operational and financial risks review)

FEASIBILITY AND FORMATION

For the feasibility and formation process, the captive owner should delineate responsibilities between the actuary, consultant, and the captive manager to avoid unnecessary cost and duplication of effort.

Feasibility Study

At a minimum, captive formations require the development of a feasibility study for review by the captive regulator. Typically, the feasibility study is initially presented to the captive owner for their review and decisions and then revised accordingly. The feasibility study includes pro-forma financial projections: balance sheet, income statement and cash flow statement; as well as net present value of cash flows and internal rate of return on investment. Sometimes the pro-forma financial projections are built by the captive manager, utilizing loss picks, five-year projections and loss payouts provided by consultant/actuary.

Additionally, the feasibility study should include the following items consistent with business purpose, objectives, and the risk appetite of the captive owner, and is typically completed by:

Consultant	Actuary
<ul style="list-style-type: none"> • Strategically review coverages to be placed in the captive and growth plans • Design program and policy, including coverage limits and retentions • Evaluate fronting carriers, as required by coverage needs • Develop loss control or prevention strategies 	<ul style="list-style-type: none"> • Project actuarially reasonable claims costs and loss adjustment expenses • Develop actuarially reasonable premium rates • Assist in risk mitigation strategies and modeling of a sound reinsurance structure including analysis of alternative structures • Consider risk margin strategy, as applicable • Model expected program expenses by line item

Consultant	Actuary
<ul style="list-style-type: none"> ● Develop reinsurance structure ● Select domicile and domicile-based service providers ● Determine captive structure (e.g. single-parent, group, segregated cell, etc.) ● Strategically review tax issues and regulatory environment ● Evaluate the various corporate structure options and capital requirements 	<ul style="list-style-type: none"> ● Probabilistically model reasonable ranges of loss scenarios ● When not providing an independent analysis, ensure the model's methods and assumptions are reasonable ● Make financial projection investment assumptions consistent with target investment strategy ● Determine that the appropriate solvency ratios fall into acceptable ranges ● Design program and policy, including coverage limits and retentions ● Evaluate the various corporate structure options and capital requirements

The feasibility study should be developed by an expert, qualified by training and experience in captive work, the specific lines of coverage being placed in the captive, financial modeling and risk analysis. The expert may be an actuary or consultant; however, many regulators require actuarial certification as a part of the process.

The format for the feasibility study or actuarial reporting can vary, but should include:

- Clear, concise information with executive summaries and a narrative that explains the program to a non-technical audience, including the sources of the data and the pricing strategy
- Presentation in a CFO/benefits person's language – in financial terms, tying into the business plan/strategic operating plan
- All information needed for actuarial peer review

Formation

The actuary and/or consultant remains involved through implementation by providing the following services:

- Fronting/reinsurance procurement and policy/treaty/administrative agreement negotiations
- Department of Labor filing where appropriate
- Responding to questions from the regulator

MANAGEMENT

Periodic Review

The actuary and/or consultant should periodically review and report on the program, typically quarterly or annually, as appropriate.

Consultant	Actuary
<ul style="list-style-type: none"> ● Review goals and assumptions from proposed/current business plans and feasibility study to determine if met ● Review compliance with approved business plan and regulatory requirements and guidelines ● Review loss prevention and claims management ● Review case reserves ● Facilitate discussions, as necessary, between membership and owners (in a group captive) ● Review relevant developments in the industry and long term trends, alerting the captive owner of potential issues along with recommendations ● Review domicile issues – onshore versus offshore, switching domiciles ● Update program design, coverage renewals, policy design, and administration consistent with the captive’s loss experience and captive owner’s needs or desires ● Determine impact of potential new lines on existing captive structure and capital requirements ● Coordinate information flow between and confirm functions of all service providers, as requested by the captive owner – legal, actuarial, consulting, audit, underwriters, claims handlers, investment managers 	<ul style="list-style-type: none"> ● Analyze updated loss experience, expenses, investment results, cash flow, reinsurance, etc. ● Review capital adequacy ● Update pricing consistent with loss experience, including risk margins as desired ● Review collateral requirements, as applicable ● Estimate cost allocations, reserves and/or dividends by subsidiary, as applicable ● Provide a certification of loss reserves and a supporting memorandum or report, as required by the captive domicile <ul style="list-style-type: none"> – Request all necessary data well in advance of the certification due date and immediately review the data for reasonableness, asking follow-up questions where necessary – Comply with appropriate actuarial standards of practice and applicable laws and regulations – Include an executive summary readily understood by the captive owner and other interested parties; take time to meet with the captive owner to deliver results and provide an opportunity for them to ask questions – Include enough detail that another actuary can follow the work – Ensure form is signed by actuary qualified by experience and training, and a member in good standing, meeting all relevant continuing education requirements of appropriate actuarial organizations (e.g. in US – member of the American Academy of Actuaries)

Derivation and Review of Key Financial Metrics

The consultant or actuary should review the proposed financial measures to determine how they compare to industry benchmarks. For example, the following are examples of benchmarks. It should be noted that ratios vary by coverage and size of program:

- Premium to surplus ratio
- Reserves to surplus ratio
- Surplus to retention
- Expense ratio
- Loss ratio

- Combined ratio
- Investment income
- Liquidity ratio

CLOSING A CAPTIVE

Closing a captive is far more complicated than simply ceasing operations. Both consultants and actuaries are intimately involved in the process of closing a captive, as provisions must be made for the disposition of the assets and outstanding liabilities.

Consultant	Actuary
<ul style="list-style-type: none"> • Review loss prevention and claims management • Discuss resolution strategies on regular basis with broker, captive manager, etc. • Notify current state of assets/liabilities, including reasonable asset assumption and advice on assets • Review options available for captive closure; (i.e., runoff, commutation, novation, loss portfolio transfer (LPT), continuation/discontinuation, and any other appropriate approaches) 	<ul style="list-style-type: none"> • Provide an annual certification of loss reserves and a supporting memorandum or report • Analyze loss experience, expenses, investment results, cash flow, etc. • Review capital adequacy • Analyze loss sensitivity within a reasonable range

B. ATTORNEY

The fundamental role of a captive attorney is to act as an independent and objective professional advisor to the captive's governing body on legal, regulatory and tax areas.

PRE-FEASIBILITY

Selecting an Attorney

While attorney selection usually occurs during the feasibility phase, attorneys must be prepared to interact with prospective captive owners at any time during the process. In order to determine the appropriate legal advisor for a captive, captive owners should:

- Contact trade organizations (CICA, etc.) to find out who is active in the industry
 - This can be accomplished by attending industry events or getting referrals from other captive owners, managers or service providers
- Evaluate attorney's ability to advise on the chosen domicile's regulatory regime
- Decide whether to use bundled or unbundled legal service packages. Some attorneys prefer to be involved in most aspects of the captive. These firms provide a bundled service package where they attend board meetings and periodically review compliance. Some are hired on an "as needed" basis

Roles and Responsibilities

Attorneys fill many roles including:

- Attorneys should be prepared to demonstrate to prospective clients (captive owners) that they have the appropriate skills and experience
- Law firms should demonstrate that their support staff is knowledgeable and responsive.

FEASIBILITY AND FORMATION

Attorneys should advise clients on the following:

- General legal issues
- Domicile selection legal issues
 - Onshore versus offshore
 - Specific jurisdiction's laws and licensing formats
- Appropriate captive ownership structure
- Tax treatment for startups or in conjunction with accountants
 - Deductibility of premiums under federal law
 - Risk shifting/risk distribution
 - Unrelated third party business
 - Brother/sister analysis
 - Overall risk pooling based on the structure
 - Taxation of the captive and shareholders by state, federal or offshore jurisdictions
 - Domestic captive
 - Offshore captive

- Controlled Foreign Corporation (CFC) issues
- Non Controlled Foreign Corporation (NCFC) Issues
- 953(d) elections
- 953(c)(3)(c) election
- 831(b) small captive election
- Treatment as a life insurer
- Federal excise tax
 - Initial
 - Cascading
- Engaging in a U.S. trade or business (ETB)
- State premium/self procurement tax exposures
- Federal filings
 - Treasury filings regarding bank accounts
- Policy of insurance, endorsements and associated forms for direct-writing captives
- Fronting reinsurance agreement
- Contracts
 - Review contracts from other service providers (TPAs, actuaries, underwriters, brokers)
 - Service provider contracts establish limited liability
- Draft business plans
 - Business purpose – make sure captive licensed to conduct business intended
 - Contents of Certificates of Authority
- US Department of Labor issues and licensure track for benefits captives
- Medicare and Stark laws for healthcare captives
- Medicare secondary payer issues and filings
- Special arrangements
 - Segregated portfolio companies
 - Retrospectively rated policies
 - Non-standard risks
- Sarbanes Oxley transparency and governance issues (for public companies)
- Section 404 compliance requirements (for public companies)

Roles and Responsibilities

Attorneys play a pivotal role in the development of a captive. A captive is like any other legal construct, it requires the full complement of legal documentation. As such, once the decision to form a captive is made, the attorney should be retained immediately to:

- Draft/review all legal documentation as outlined below
- Counsel on local law compliance
- Ensure that documentation and business plan are consistent
- Review and comment on licensure application and exhibits

Governing Documents

The lawyers create governing documents for the captive. Documents should be worded to prevent or

minimize the need for them to be rewritten as the captive grows or changes. Organizational documents include articles of incorporation, bye laws, conflict of interest statements, and those required by or relevant to board and committee functions.

- Draft/review insurance (for direct-writing captives) or reinsurance policies
- For group captives, legal input should be provided on:
 - Private placement memoranda and updates
 - Organizational structure
 - Shareholder agreements
 - Disclosures
 - Share records, including purchases, sales and redemptions
 - Securities and Blue Sky laws
 - Regulation D filings

MANAGEMENT

Roles and Responsibilities

When there are substantive changes to the captive program, these changes should be reviewed by legal counsel and other advisors. Generally, attorneys should:

- Have awareness of, if not direct interaction with, boards and key committees
- Review minutes of all board meetings before approval
- Participate in annual general or shareholder meetings
- Advise on changes in law, as needed
- Advise on changes in contracts
- Review local law compliance
- Review tax position, including deductibility and loss reserves
- Review tax compliance and ensure that documentation follows the structure
- Ensure tax compliance, as requested
 - For US offshore entities evaluate:
 - US trade or business issues
 - Federal excise tax issues
 - Various elections
 - Income reporting
 - Reporting potential issues to the accountant
- Advise on applicability of Solvency II
- Provide an annual “Wellness checkup” – which is a discussion with an attorney regarding changes that have been made over the year in order to remain compliant with domicile, tax, regulatory environment and insurance requirements. Ideally, this should be done in concert with the captive manager’s annual stewardship report
- Advise on domestication of offshore captives
- Provide notice of board meetings, draft minutes, and coordinate board books with captive manager five days prior to meeting

CLOSING A CAPTIVE

A lawyer should assist with the closure of a captive including:

- Analyze dissolution/liquidation
 - Prepare formal legal documentation
- Oversee and confirm that implementation meets legal requirements
 - Determine shareholder/stakeholder rights to distribution
 - Evaluate tax and related implications
 - Review treaty reinsurance commutation documentation (if any)

C. CAPTIVE MANAGERS

Captive managers provide general guidance relative to the formation and application process. Once the captive is established, managers perform the daily accounting and bookkeeping work and regulatory oversight. This includes the quarterly or annual financial statements.

Captive managers are often located within the chosen domicile, and generally have a close working relationship with the captive regulators. It is important to remember that in some domiciles the manager acts on behalf of the captive owner, who is ultimately responsible to the regulator. In other domiciles, the captive manager is ultimately responsible to the regulator, not the captive owner. In those domiciles, one of the most important captive management functions is to act as the “eyes and ears” of the captive owner relative to the variety of compliance issues in each domicile. Captive owners should understand their managers’ role to remain constantly aware of changing regulatory requirements.

There are varying levels of engagement for captive owners to work with captive managers. A captive manager role can range from complete outsourcing of functions to working with the captive owner to provide the domicile-required minimum level of service. The level of engagement will depend on the goals and objectives of the captive owner, and should be outlined in the initial agreement. There are three potential levels of engagement. The initial agreement should make it clear as to the level of engagement:

-Work exclusively with the captive manager
-Co-source the work with the captive manager and others
-Outsource all of the work

PRE-FEASIBILITY

The captive manager does not normally participate in the pre-feasibility phase of the decision model. However, there are times when a prospective captive owner will contact a captive manager in order to initiate the decision-making process. In these instances captive managers must be capable of discussing the minimum eligibility requirements for considering captive ownership. These include the various minimum statutory capital requirements, corporate structures and board composition, annual meeting requirements, underwriting and business plan development as well as guidance on tax issues relative to the captive structure.

Selecting a Captive Manager

When choosing a captive manager, captive owners should refer to domicile regulations, making sure the captive manager is approved and/or properly licensed by the regulator and meets all requirements of the domicile. Some domiciles require captive managers to be licensed, while others review the credentials of the captive manager. Each domicile has its own evaluation criteria, and may review the following as part of the captive management firm’s approval process:

- Business plan showing sources of business details of captive managers, directors, and officers, and

requiring them to be “fit and proper persons”

- Financial strength of the entity and financial responsibility
- Corporate governance of the operations
- Insurance experience
 - Adequate experience in insurance and reinsurance operations
- Background of Board of Directors and management personnel to determine that no restrictive or disciplinary order has been imposed by any regulatory authority, and there have never been any convictions for insurance fraud
- Reputation
 - Known for its expertise and experience, including proper oversight of financial and administrative affairs
- Use of appropriate processes such as the IMF requirements, “Know Your Customer,” to make sure appropriate anti-money laundering procedures are in place
- Minimum levels of insurance coverage for:
 - Professional liability
 - Errors and omissions
 - Fidelity bonds

Domiciles with specific licensing or compliance requirements usually impose penalties on captive managers that do not meet one or more of the requirements, including suspension of its right to operate in that domicile.

In addition to the above, it is recommended that captive owners do the following:

- Meet with key staff and management of the captive management company to ensure that both parties are able to effectively work together
- Ask for at least 3 business references and take time to engage references to get to know captive manager’s strengths and weaknesses
- Contact regulator to confirm that captive manager is authorized and in good standing in the domicile
- Ask for samples of stewardship reports to gauge performance quality and attention to detail
- Discover “other resources” that the captive manager may be able to provide outside of their traditional captive management role

FEASIBILITY AND FORMATION

For the feasibility and formation process, the captive owner should delineate responsibilities between the actuary, consultant, and the captive manager to avoid unnecessary cost and duplication of effort.

Potential Roles and Responsibilities of Captive Managers

Captive managers are capable of performing a variety of functions. However, some of the functions described here are more likely to be performed by a captive consultant or an actuary. This does not mean, however, that captive managers should refuse to perform any of these roles; it simply means that they are not usually asked to undertake some of the functions described here, but are expected to facilitate and coordinate these services.

- Advise captive owners as to why companies form captives, including advantages and disadvantages, tax effects, corporate governance work, regulation, capital implications, risks, costs, etc.
- Develop captive business plan or, at a minimum, provide necessary templates to ease the burden of a captive owner who is not experienced in writing business plans
- Understand requirements to seek approval for plan changes based on captive operation and domicile regulations (including whether file and use notification or more formal documentation is required) and have the capabilities to respond to them
- Facilitate introduction between regulator, owner and any of the other service providers (i.e. actuary, auditor, bankers, investment advisor, etc.)
- Communicate often with the captive owner to keep information flowing. It is in this early stage of the relationship that questions are abundant, especially if the captive owner is new in the business
 - In a segregated cell captive, or other captive structure with multiple member owners, an effective communication structure should be established to explain how everything works at the outset as well as over the life of the program
- Assist owner in developing mission statement, goals, objectives, and risk management/financing strategies
- Educate captive owner and Board of Directors on operating a captive insurance company
- Provide basic insurance accounting summary to captive owner and staff
- Establish and maintain books and records for captive
- Inform regulator of any changes in contact information or captive team
- Operate under written service agreements
- Facilitate feasibility study, if applicable, and outsource actuarial work as necessary
 - Submit five year financial pro-forma with application

Contracting for Captive Management Services

The area below outlines some key considerations as a captive owner contract in with a captive manager:

- Length
 - Contracts between captive managers and owners of group captives should be no more than 3 years
 - Pure captive owners should periodically solicit bids for competitive prices and services in a manner consistent with corporate practices
 - Multi-year agreements should be reviewed at least annually
- Cancellation
 - Timing of captive management changes should not conflict with current or pending audits in order to avoid communication issues around fiscal year end
 - Ownership of electronic data should be agreed, along with terms related to data transfer in the event of a change of captive management
 - Cancellation provisions in the contract should provide for an appropriate length of time; for example, no cancellation until after the first year
- Terms
 - Captive managers should provide complete transparency regarding their fees, including relationships with other service providers, full disclosure of all fees and other arrangements and fee-sharing with other offices, if part of a large service organization

- Service agreements should encompass duties tied to measurable activities
- Payment terms for multi-year agreements should be specified

Key Performance Indicators

In the original service agreement, key deliverables required from the captive manager should be listed. Captive owners will need to find ways to determine quality, timing, and accuracy levels expected for these deliverables. Some captive owners may provide financial incentives that provide for a financial penalty/reward system relative to the captive management fees (e.g. 10% of fees at risk) based on a regular review of the captive manager’s performance against the agreed upon key performance indicators.

Insuring Agreements, if provided

In some cases captive managers are called upon to write and issue the contract of insurance. This may be the case when the captive is a “direct writing” captive, i.e., a non-fronted captive. Fronted captives’ insurance policies are provided by the fronting insurer.

- Pre-binding documentation expectations
 - Provide complete, accurate documents, received before actual binding date
 - Ensure 100% contract certainty before releasing policy; make sure captive owner has met obligation to provide data in order to produce documentation
 - Provide expertise to assist captive owner in making sure documents include customary insurance/reinsurance terms
 - Highlight payment flow expectations and address any pre-payment obligations; if there are changes to program, review for regulatory and tax compliance
 - Within 30 days of binding, create the specific goals and objectives of what captive manager should be working towards
- Post-binding documentation expectations
 - Provide all policies in format requested
 - House documents in central location. This may be hard copy, online or another format depending on client preferences
 - Track all documentation through to completion
 - Track all payment obligations through to completion

MANAGEMENT OF THE CAPTIVE

Roles & Responsibilities

The roles and responsibilities of the captive manager are varied and can include that the captive manager offers some or all of the following:

- Discuss all actions with the captive owner to ensure appropriate communication
- Provide staffing levels and turnover, assuring the client manager has the capacity to fulfill their responsibilities
- Coordinate information flow between and confirm functions of all service providers, as requested by captive owner – legal, actuarial, consulting, audit, underwriters, claims handlers, investment

managers, reinsurers

- Maintain current business plan on file, including copies of policies, agreements, organizational documents, financial projections, claims records, underwriting guidelines and rates
 - Make records available for client or domicile authorized inspection
 - Maintain copies of all service provider agreements, including those subcontracted by the captive manager, if applicable
- Develop and maintain regulatory relationships
 - Make arrangements for meetings with regulators
 - Review regulations and tax changes that will affect the captive and raise any issues or concerns, and report back to the captive owner
 - Report the following to the regulator as required by domicile regulations:
 - Financial, ownership or operational changes to the captive that will affect the nature of the insurance business conducted
 - If a pure captive, changes at the parent level may require approval and should be reported to the regulator prior to public release
 - Updated financial statements and pro-formas when there are changes to the plan
 - Adverse financial conditions that threaten the captive’s solvency compliance
 - Business plan changes
 - Violations of domicile laws
 - Statutory reports as required by the domicile
 - Annual audited financial reports and tax returns
- Attend shareholder, member and director meetings as appropriate
 - Notify participants of dates and times of meetings and prepare documents for use
 - Create and distribute the board books: agendas, discussion materials, meeting minutes and resolutions
 - Confirm position of captive manager at meetings (i.e. as a service provider or a Board member)
- Meet with captive owner(s) periodically to review financials, regulatory filings, and any other activities requiring captive owner attention
- Review other domicile options with captive owner, especially when another domicile makes beneficial regulatory changes
- Provide market research on letters of credit, NY Regulation 114 Trusts, security requirements, and available alternatives
- Meet or exceed these requirements and maintain a long-term, close relationship with captive regulators, in order to engender a level of trust that inures to the benefit of the captive owner. Captive owners can only find out about this aspect of best practices by confidential discussions with the marketplace, including other captive owners.

Financial Reporting

The captive manager should consistently monitor a captive’s compliance with domicile requirements. In some cases, remedial actions may be required as a result of financial irregularity or market conduct issues. As appropriate, captive managers should report adverse findings to regulators and captive owners, and work with regulators to prepare a remedial action plan.

Ideally, captive managers should also designate a time frame for completing financials in conjunction with the captive owner. Financial reports should be produced at least twice a year, but could be developed as frequently as monthly, given the needs and complexity of the company.

Ideally, once all information needed to produce financials is received, captive managers should compile financial reports for all shareholders and members of the captive. Financial statements should be produced in accordance with GAAP, STAT, IFRS or another agreed recognized method of accounting, in an auditable form for the domicile regulator and auditor, and delivered in an agreed-upon format. The statutory financials should include regulatory solvency calculations and any other financial ratios deemed helpful by the captive manager and captive owner in managing captive financial affairs.

Captive managers should periodically review reinsurance cession statements provided by the captive owner or any other entities to make sure the financials are correct. At a minimum, the following schedules should be validated:

- Premium statement/schedule
- Reinsurance recoverable statement/schedule, if available
- Loss reserving
- Investment values and activities

It is also helpful for the captive manager to hold regular conference calls to discuss policy renewals and cash activity with the captive owners.

Compliance Reporting

Meeting regulatory deadlines consistently is a minimum requirement. As a result, it is recommended that captive owners require compliance reports from captive managers with the minimum reporting threshold being the exception, with the majority of companies meeting deadlines in advance. If the captive funds benefits, the benefits manager needs to be aware of the need to meet the deadlines. If regulatory deadlines cannot be met, captive managers should request an extension as soon as possible.

For RRGs, on a quarterly basis, the captive manager should produce reports that list by state by date:

- All premium tax filings that have been completed
- Board, bureaus and assessments
- Convention blanks
- Explanations of dates missed and assurance that payments were made on applicable penalties

Internal Controls

Internal controls should be in place and should be discussed, reviewed at annual meetings, well documented and sent to the audit committee to provide captive owners with an understanding of their captive manager's stewardship of the account.

For example, captive managers may provide specific services, like banking functions, at the request of a captive owner. Specific internal controls should be part of all captive manager banking administration

tasks in order to control access to the captive owner's financial accounts. These may include, but not be limited to:

- If captive manager is signing checks, a limit should be placed on the amount the captive manager can issue a check for (e.g., \$25,000) and dual signatures should be required
- If captive manager is handling incoming money, controls should include robust procedures for following up on accounts receivables and outstanding invoices at specific intervals
- Bank statements and cash should be reconciled regularly (e.g. monthly)
- Receipts should be reviewed weekly

Back Office Support

The specific responsibilities of the captive manager should be codified in a contract with the captive owner. Upon request, the captive manager should be able to provide the following daily services:

- Undertake general administrative tasks of the account, including setting up travel arrangements, holding meetings, and managing relationships
- Provide timely issuance/response regarding certificates of insurance, bonds, auto ID cards, or similar requests (if manager provides this service)
- Issue accurate insurance binders and/or cover notes correctly prior to renewal (if manager provides this service)
- Assist in the implementation, coordination and monitoring of TPA and/or other service providers
- Provide timely completion and delivery of insurance program summaries (if manager provides this service)
- Provide meaningful comparative analysis (e.g. loss ratios), including insurance coverage analysis and answering ad hoc questions
- Pay reinsurers on a timely basis when fronting program is utilized
- Collect payments from reinsurers on a timely basis, if applicable
- Meet captive owner IT expectations by providing data security and a disaster recovery plan

Stewardship Report

Most domiciles require that their captive hold at least one annual meeting. Captive managers may offer their stewardship report as a board item, included in the board books. If a board-approved item, an annual stewardship program should be developed to demonstrate the captive manager's activities, including a review of the key performance indicators agreed to by the captive manager and owner. Additionally, it is recommended that an interactive ongoing list of open and outstanding items be used as a tracking/management system to determine whether the captive manager is truly managing the process.

Claims Advocacy

If this service is provided by the captive manager at the request of the captive owner, the following responsibilities would apply:

- Assist with claims handling
 - Facilitate loss notification and recovery process by providing advice and utilizing sales leverage

with insurer

- Facilitate and expedite potential claim recoveries associated with insurers in runoff/liquidation or in a Scheme of Arrangement

CLOSING A CAPTIVE

When a captive is shut down, the captive manager must fulfill certain obligations in regards to the captive owner and the regulator. All previously described expectations still apply during shut down, and the regulator will rely more heavily on the captive manager to:

- Communicate with the regulator frequently regarding
 - Status of the program
 - Disposition of the assets and satisfaction of the liabilities
- File a detailed plan of how the shutdown will work
- Assist with design of final exit strategy, including:
 - Commutation of reinsurance treaties (if any)
 - Loss portfolio transfer design and negotiation
 - Runoff provisions

D. AUDITOR

ROLES AND RESPONSIBILITIES

Meeting Applicable Standards for Qualification as an Auditor

The auditor should be identified and engaged as part of the feasibility study. However, the main functions of the auditor occur at the end of each calendar year.

- Meeting compliance standards/deadlines should be a minimum standard
 - This responsibility is shared with the captive manager
- Specific audit requirements vary by domicile, but the basic approach should be for the auditor to understand and comply with applicable domicile specific requirements

Selecting an Auditor

When choosing an auditor, the captive owner should make sure that both the firm and the engagement team have relevant experience in the industry. This includes the following:

- Experience with insurance company accounting issues (for example, loss reserve and reinsurance accounting)
- Deep understanding of tax implications
- Capacity to meet timing requirements of captive owner

Developing a Project Plan

It is important for auditors to discuss the unique aspects of the captive in advance as part of the planning stage with the captive owner, consultant/actuary and captive management personnel. During this discussion, expectations should be established, including deliverable dates, the information required, and milestones.

One goal of project planning is to develop and maintain open, ongoing communications. In some cases, auditors interact with the captive manager, but do not directly interact with the captive owner. Communications should be inclusive (captive owner, consultant/actuary, captive manager and auditor) unless it is specifically determined to be unnecessary by the captive owner and the auditor.

The Audit Report

The auditor and the captive owner should agree in advance about the anticipated form of the auditor's opinion in order to meet regulatory needs, and the planned use by the captive owner.

Some audit reports may have qualifications and/or limitations as to use. Auditors should provide a draft of the anticipated qualifications to the captive owner. Once this is outlined, the audit committee or Board of Directors should seek approval from the parent company and confirm that the document meets the company's needs.

Timing of Audits

The timing of audits usually follows the fiscal year end and/or specific domicile guidelines. The timing of audits should be coordinated, and the auditor and captive owner should:

- Identify in the planning stage of the audit what confirmations are planned and the correct person to send them to, then confirm with captive manager or owner
- Agree on timing for milestones of audit
- Agree on timing for issuance of audit and maintain timetable to prevent the possibility of additional work, such as subsequent event updates
- Coordinate nature and timing of other third party information

Attending Board Meeting

Communication channels should be kept open throughout the term of service. Often an auditor's direct interaction with the captive owner is limited; they may interface with the captive manager more frequently. Ideally, auditors should have an annual face to face meeting with the captive owner to clarify the company business plan, future planned activities and audit questions.

Sufficiency of Audit Documentation (Audit Work Papers)

The auditor's supporting documentation should not only be in compliance with applicable auditing standards, it should be prepared in contemplation of its anticipated use by captive regulators. Such documentation is typically used by the regulator as part of the examination process. As a result, the more clearly the auditor's documentation evidences the procedures performed and the results thereof, the more efficient the domicile regulator's examination process should be. The goal should be to document work at a sufficient level of detail so that the domicile regulator may rely on the audit work to more expeditiously complete its triennial exam in an efficient manner.

Captive owners may decide to work with a separate auditor rather than a parent company auditor. If the captive owner chooses to work with a separate auditor, he or she must decide in advance how information will be shared between the two auditors, and the required timing of such information. Protocols for communications between the different auditors should be established.

Maintaining Good Working Relationship with Auditor

It is often efficient to work with the same audit firm from year to year. Additionally, consistency in audit engagement team members from year to year promotes an efficient audit. It is a best practice for the auditor to inform the client as to the engagement team composition and roles at the beginning of each annual audit engagement. When new members join the audit engagement, the captive owner should be introduced to the engagement team and confirm that all members of the team continue to have the needed qualifications.

Auditors should be collaborative in working with the captive owner and captive manager, while meeting auditing guidelines. Material changes to the financial statement presentation or the unaudited financial statement that become apparent during the course of the engagement should be brought to the captive owner's attention immediately.

CONCLUSION

This is the work product of several groups of enthusiastic professional service providers who volunteered their time and expertise towards the betterment of our business and its place in the pantheon of global financial services.

While we attempted to cover as many best practices as possible for each professional discipline, we understand that this is a work in process. As with any evolving business endeavor, the CICA Best Practices Guidelines will continue to reflect that which we consider to be the most professional and most ethical of captive business practices and procedures.

In order to remain responsive to the captive community and continue to reflect its best professional efforts and ethos, we enthusiastically encourage any and all comments and suggestions that may enhance the value of this publication. We also invite questions; those general in nature and those related to specific best practices or recommendations.

IV. RESOURCES

SOLVENCY II

ECIROA - The European Captive Insurance and Reinsurance Owners` Association

<http://www.eciroa.org>

GUERNSEY CAPTIVE MANAGER GUIDELINES

IAIS Guidance Paper on Regulation and Supervision of Captive Insurers

<http://www.iaisweb.org>

SOUTH CAROLINA CAPTIVE MANAGEMENT REQUIREMENTS

South Carolina Department of Insurance Bulletin 2008-03

<http://www.doi.sc.gov/NR/rdonlyres/A320F7E9-EF4E-4AE3-A4B2-66C694D28964/0/Bulletin200803CaptiveManagementRequirements.pdf>