Risk Retention Groups in the Transportation Sector

Captive Insurance Company Reports
April 2019

Editor's Note: Now we have an insightful analysis of risk retention groups (RRGs) and trucking by **Jon Harkavy,** general counsel at Risk Services, LLC. He can be reached at jharkavy@riskcompanies.com.

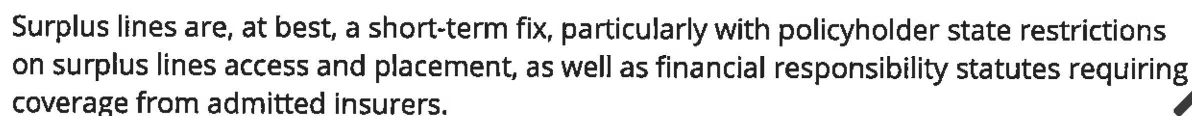
Judging by the experiences of Risk Services' RRG clients in 2018, RRGs have become an increasingly attractive structure to meet the rapidly hardening market in the transportation sector, particularly in the trucking industry. Indeed, transportation may in several years challenge health care as the dominant RRG sector.

Among Risk Services' RRG clients in the transportation sector, 2 RRGs have increased premium volume over 40 percent in 2018, and 2 new transportation RRGs have been added in the past 3 months, buoyed by the hardening market. And a hardening market it is; fueled by loss experience well in excess of 100 percent in many sectors of the transportation industry.

Obviously, insurance availability/affordability will increase interest in captives/RRGs, but there may be something more long term with respect to RRG growth in the transportation sector.

While rate increases are fueling both the traditional and surplus lines market's interest in the transportation sector, RRGs might ultimately represent the best long-term solution for policyholders, as the sector's problems cannot be fully addressed by rate increases alone.

Faced with deteriorating loss experience, traditional insurers are often without the form and rate flexibility needed to address renewal premium inadequacy and/or needed coverage form revisions.



Surplus lines are, at best, a short-term fix, particularly with policyholder state restrictions on surplus lines access and placement, as well as financial responsibility statutes requiring coverage from admitted insurers.

Perhaps most important, the causes of the transportation sector's deteriorating loss experience are diverse and demanding of arduous underwriting, which surplus lines and even traditional insurers may not be able to viably provide effectively as RRGs.

Other Factors Facing the Trucking Industry

The plethora of factors triggering the transportation sector's burgeoning loss experience cannot be viably met by simply throwing price increases at the insurer. Skyrocketing medical costs are certainly increasing court awards and settlements.

The trucking industry, faced with a tight employment economy, is retaining and hiring less experienced or qualified drivers. Distracted driving—whether caused by texting, eating, or viewing navigational systems—is to blame for some 3,000 deaths in 2017. Each year, some 400,000 are injured in commercial motor vehicle accidents generated by distracted driving. Moreover, outside investors are funding more and more tort cases, and trial lawyers often inveigle insured defendants to assign claims, thereby increasing the number of actions brought and related settlements.

Yet perhaps the biggest factor in the deteriorating losses of the transportation sector is, on the one hand, the most obvious and, on the other hand, intuitively misleading. Perhaps as a result of lessening gas prices, the miles driven per vehicle has gone up about 3 percent a year over the past 7 years. However, the increase in miles driven per commercial vehicle is not linear but rather exponential, with accident and death rates outstripping miles driven.

The Role of RRGs in Transportation Insurance

Against this backdrop, RRGs do have some structural advantages to compete against their typically better capitalized traditional insurers. Most of our transportation RRG clients secure not insignificant capital contributors from their policyholders, with typically 3–5 years of vesting periods after their insurance policy terminates before the capital will be returned.

This discourages a "run on the bank" when soft markets would otherwise prompt insureds to cancel their coverage for a reduction in premium by another insurer. So, when the market hardens, as it will, those commercial auto policyholders entering the RRG space may need to look at the RRG as a long-term commitment rather than a short-term fix.

Another factor favorable to RRGs in serving the transportation sector is that the coverage provided by RRGs can often comply with financial responsibility requirements imposed on commercial vehicle operators either because of the provisions of the Liability Risk Retention Act prohibiting discriminating against RRGs, based on out-of-state licensure, or in the case of interstate trucking and for-hire passenger vehicles, the Federal Motor Carrier Safety Administration (FMCSA), a part of the US Department of Transportation.

FMCSA statutes permit designated vehicles operating in interstate commerce to operate nationally on the basis of an insurance policy provided by an insurer licensed in at least one state, which permits an RRG to offer qualified coverage based on its single state licensure. However, RRGs' most significant advantage could be in their willingness to allocate significant resources to the underwriting and loss control functions to deal with the transportation sector's deteriorating loss ratio.

The Relationship Advantages of an RRG

Our RRG trucking clients, while retaining seasoned insurance service providers, have boards composed of grassroots trucking executives, officers, and employees of independent drivers and small-to-medium fleets. These individuals sit on their RRG's underwriting, claims, and loss control committees, often assisting production by reviewing membership/insurance applications where, because of industry savvy, they can recognize attractive potential RRG members from those likely to be higher risk or less desirable.

The trucking industry officials often provide invaluable assistance in evaluating claims based on their knowledge of industry practices. It is often possible for an RRG to take on a more productive consultative role with its clients when the RRG's board and operating committee are composed of those in or most familiar with the trucking industry.

The relationship between policyholder and insurer becomes much less like a zero-sum game where the gains of one party are the losses of another and to a significant extent the "we versus them" attitude is ameliorated. This "we" component can be further augmented by safety dividends or reductions in premium for policyholder members of the RRG through the economic realization that improving loss results of the RRG are shared by the members and not "lost" to the RRG.

Conclusion

In summary, while RRGs can certainly be a major player in the rapidly hardening insurance marketplace of the transportation sector, the real question is whether their increase in market share will represent a temporary bridge solution or more RRGs as long-term players in the transportation insurance sector.

Short-sighted RRGs will view the hardening market as a "make hay while the sun shines" opportunity to grab premium and insureds while they can, recognizing that a majority of their insureds will split after the market softens. However, the more sagacious RRGs see long-term opportunities in the transportation sector, including stable market share in both soft and hard markets and a wider pool of superior potential insureds from which to choose from, including those with superior experience and internalized loss minimization programs.

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.

CICR News and Views

Captive Insurance Company Reports
April 2019

The 28th World Captive Forum was held recently, at the end of January, at a familiar haunt, Turnberry Isle Resort in Aventura, Florida. It will return there in 2020.

This meeting, which has changed ownership several times over the past few years, remains a good conference for the captive industry. It draws many parties who do not attend many, or any other, such events.

If one comes seeking a hot captive prospect, the trip is probably wasted, but if you are looking for fronting and/or reinsurance markets, you will find them.

The title, World Captive Forum, however, does not actually reflect all of the world of captives. Mostly, as usual, it is about the prejudices of the owners and operators of the event. There was no one from Labuan, Singapore, or Dubai, for example, and they are major captive centers.

The program quality varies each year, as with most conferences, being highly dependent on the availability of speakers and topics. And, with this conference being in midwinter, the timely arrival of speakers and attendees during bad weather is always suspect. Occasionally, it is nonexistent.

This year's conference committee and leadership did a fine job in delivering a good event with several interesting speakers and relatively untouched topics. More on that within this issue of *CICR*, as reported by Editor Emeritus **Hugh Rosenbaum.**

As with all other conferences, the prejudices of the producers become evident. We know how important Bermuda is as a domicile to the industry, but, despite its views, it is not alone as such. Nor is it necessarily the best domicile for all interested in a captive. The hand of Bermuda is still pretty pervasive at the Forum. It was some time after the conference's origination before Cayman could even show up. Once it was a small world. It is a bit bigger today.

While several onshore domiciles were quite visible, there remains a slant toward offshore as being the only serious choice, and really only one of those.

And there are good service providers other than just the publicly owned big names.

It was an informative and well-managed conference, well worth the time.

~Michael Mead, CPCU, *CICR* Editor
Mike.M@authors.irmi.com

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.

Cyber Risk Presents a Devious Data Dilemma

Captive Insurance Company Reports
April 2019

Editor's Note: Below, **Aaron Hillebrandt,** a consulting actuary with Pinnacle Actuarial Resources, Inc., helps us navigate the cyber risk data minefield. Contact him at ahillebrandt@pinnacleactuaries.com.

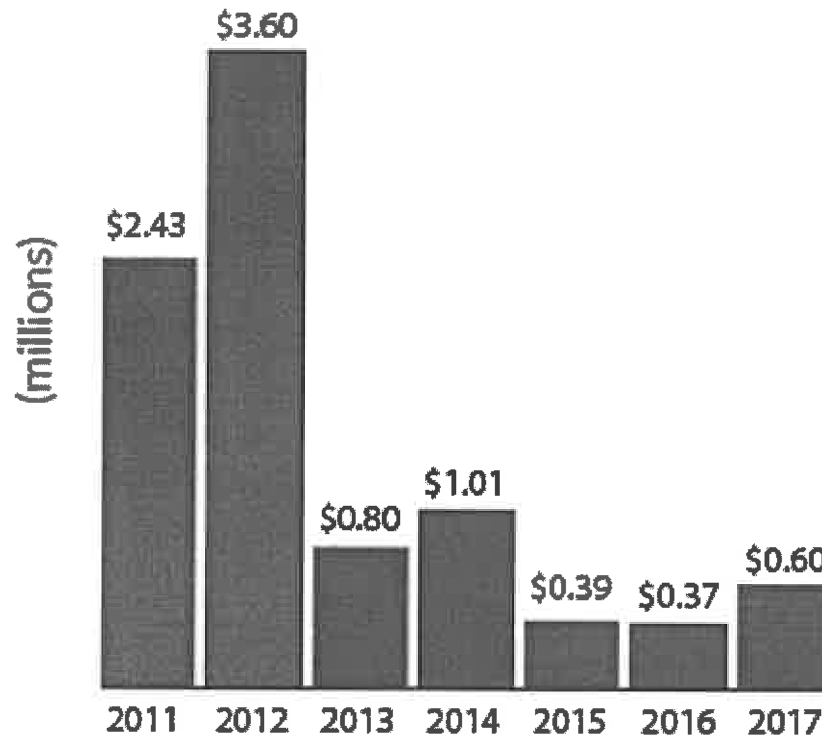
As an actuary, I'm constantly searching for consistent, reliable data. I sometimes catch myself daydreaming that cyber risk data is like workers compensation data—that I can easily find a benchmark loss-cost or loss-development pattern for a given market segment in most any scenario. But then I snap back to reality and find myself standing in the middle of a cyber risk data minefield.

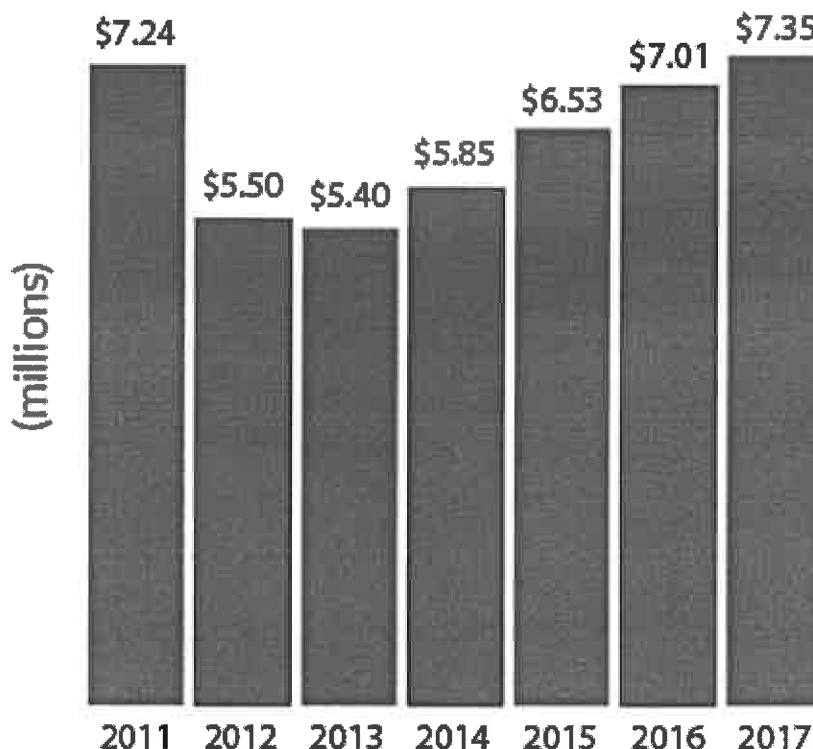
Several organizations aggregate, analyze, and publish cyber risk-related data studies, such as studies on data breaches. It's tempting to pull some data from one of these studies, then we're off to the races, right?

But cyber risk data is not so easy. Since cyber risk data reliability is in its infancy, we must analyze a given study itself before we use its data. Why was the study conducted? What was its data source? What type of data is it? How much massaging, filtering, and adjusting was done?

Different Data

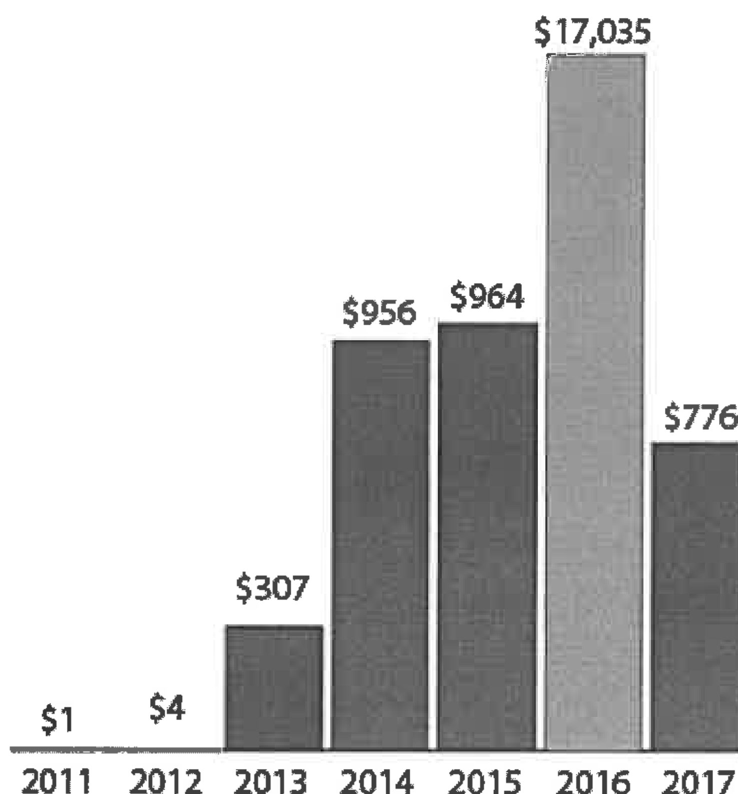
Take, for example, the below graphs of average data breach costs from two cyber risk study authors: the NetDiligence 2017 & 2018 *Cyber Claims Studies* and the Ponemon Institute 2017 & 2018 *Cost of a Data Breach Study: Global Overview* sponsored by IBM Security. Note that the Ponemon data shown below is specific to the United States while the NetDiligence data is from multiple countries; however, at least 94 percent of the NetDiligence cases are from US organizations.


Average Total Cost of a Data Breach
(millions)
$2.43
$3.60
$0.80
$1.01
$0.39
$0.37
$0.60
2011
2012
2013
2014
2015
2016
2017
Source: NetDiligence® 2017 & 2018 Cyber Claims Study

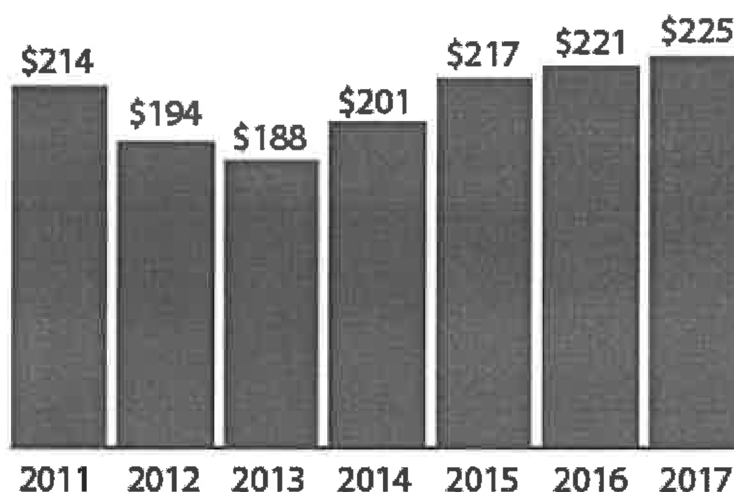


Source: Ponemon Institute 2017 & 2018 *Cost of a Data Breach Study*

The NetDiligence graph, above left, indicates average cost per data breach in recent years of less than $1 million. The analogous graph, above right, from Ponemon, shows average cost per data breach for the same time period of around $7 million. This difference is a multiple of at least 7—in other words, 1 metric is at least 700 percent of the other. How can there be such a large difference? Now, let's instead consider the average data breach cost *per record breached*.



Source: NetDiligence® 2017 & 2018 *Cyber Claims Study*



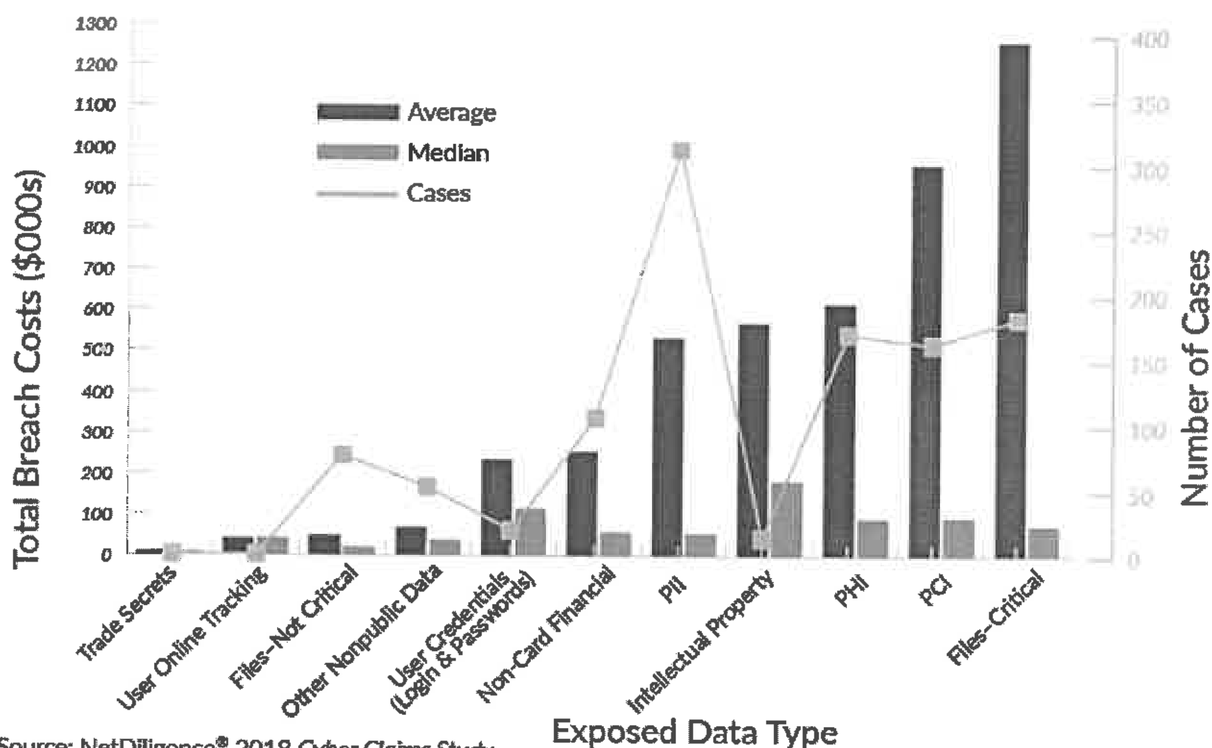
Source: Ponemon Institute 2017 & 2018 *Cost of a Data Breach Study*

The NetDiligence graph, presented above left, shows extreme volatility in the average cost per record, varying from about $1 per record in 2011 to about $17,000 per record in 2016. The analogous graph from Ponemon, above right, indicates the average cost per record in recent years has been relatively stable, between $200 and $225. How can the average cost per record be simultaneously extremely volatile and relatively stable?

Understand What the Data Represents

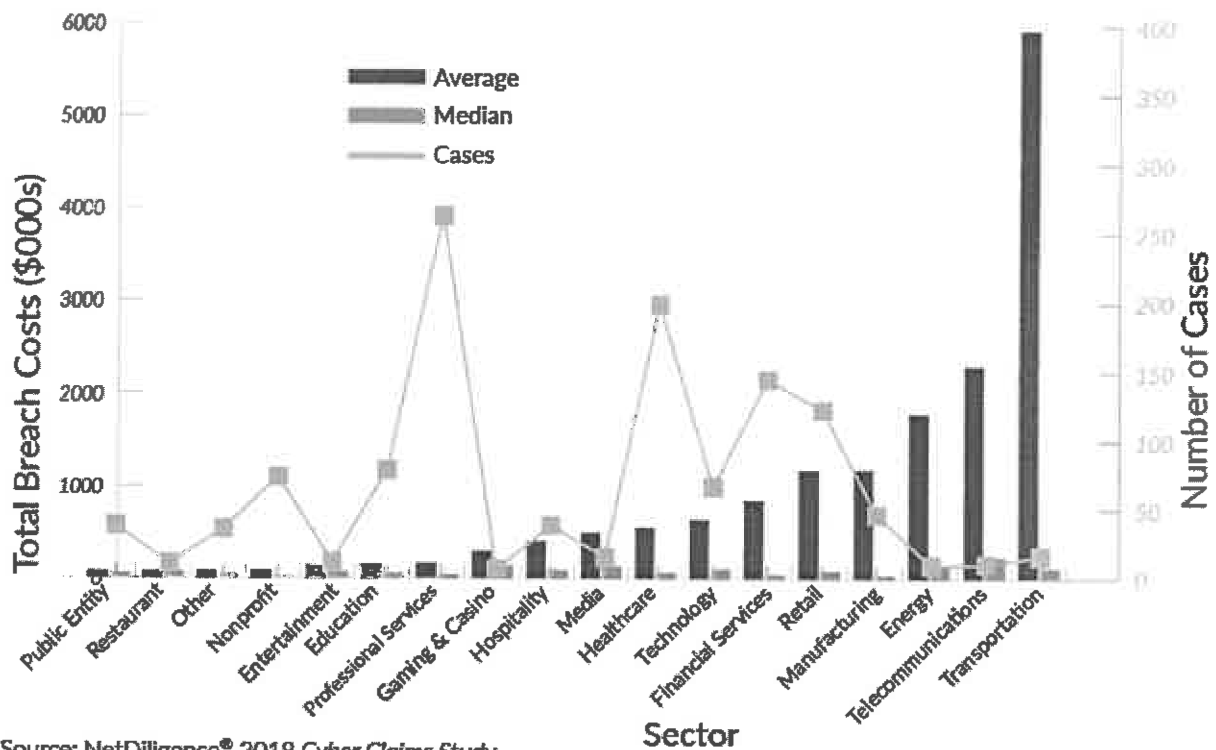
As it turns out, the NetDiligence study uses insurance claims data, which include some very small and very large claims. Between 2013 and 2017, the smallest and largest claims in their database were for $110 and $80 million. This helps explain the higher volatility we see in the above graphs. Ponemon's data is not insurance claims data. Breach costs are based on activity-based costing and include indirect costs (like increased time spent dealing with the breach) and opportunity costs (like reputational damage). This accounts for the higher average cost per breach ($7 million from Ponemon versus $1 million or less from NetDiligence). In addition, Ponemon's database targets breaches of 100,000 or fewer records because incidents with larger numbers of records breached "are not typical of the breaches many organizations experience." This explains the more stable results in the Ponemon study.

Now that we understand the differences between the databases, we will focus solely on the NetDiligence study, as it presents some additional ways to segment the historical breach cost data. The next several graphs have a similar structure. There are two bars for each category: blue bars represent the average breach cost, and orange bars represent the median breach cost. Because a median is not influenced by extreme outcomes, we can view the difference in the heights of the bars as a barometer of the extent to which a small number of large breaches influence the overall results—a large difference in bar height represents a significant influence from large breaches. Each graph also has a gray line, which represents the number of breaches producing those results—the fewer the breaches, the less stock we should place in those results due to lower statistical credibility. From left to right on each graph, we are moving from the lowest to highest average cost. First, we will consider the data type exposed in the breach.



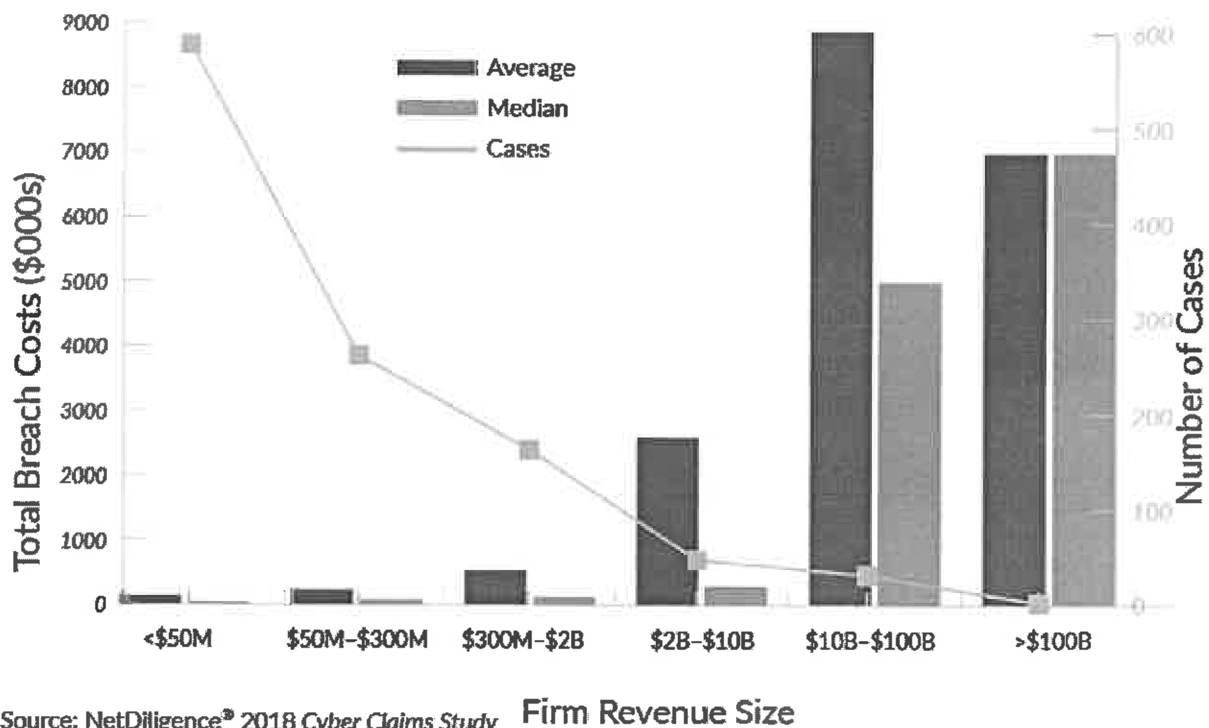
Source: NetDiligence® 2018 *Cyber Claims Study*

Critical files, payment card information (PCI), and protected health information (PHI) each have a larger number of breaches and high average costs, albeit with significant influence from a small number of large breaches. Personally identifiable information (PII) is by far the most common type of data breached, and the average cost is more comparable to PHI than PCI or critical files. Categories like intellectual property have very few breaches underlying their results, so we should place little emphasis on them. In other words, when the results are based on only a handful of claims, the next handful might look completely different. Now, let's slice the data by sector.



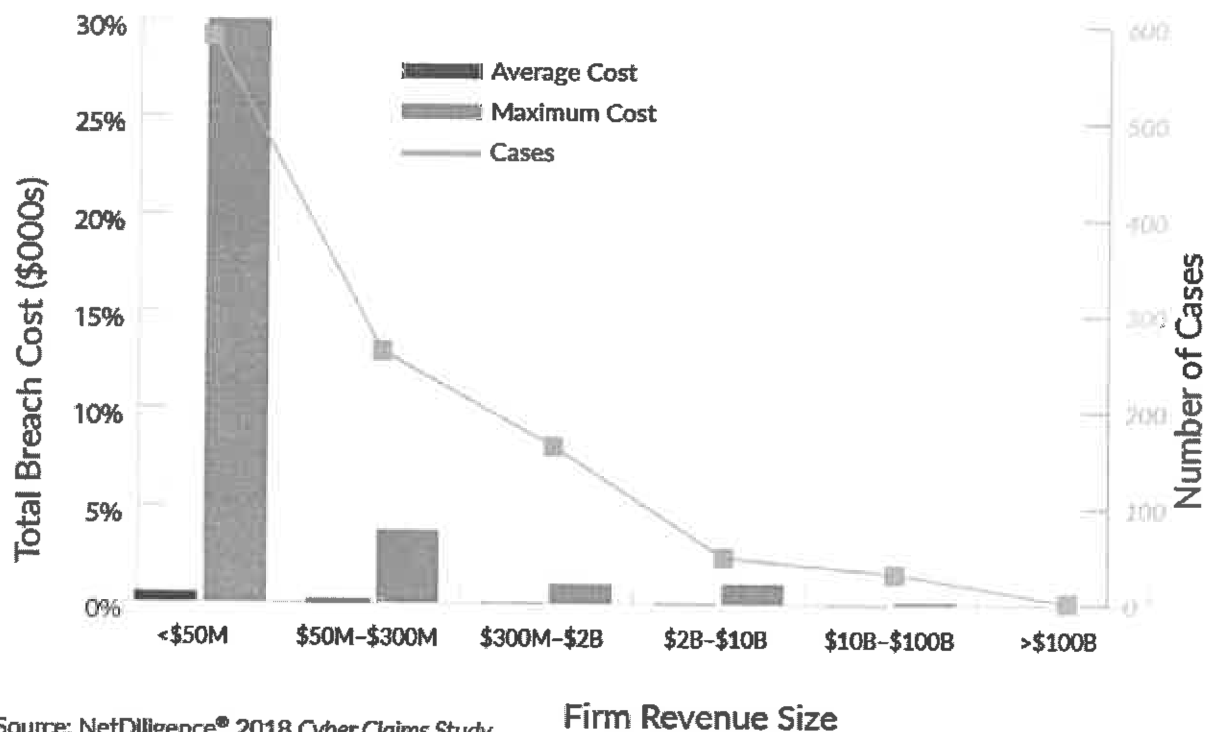
Source: NetDiligence® 2018 *Cyber Claims Study*

The highest (and most skewed) average breach costs by far come from the transportation sector, but there are only 17 breaches supporting this result. Retail, financial services, health care, and professional services have more significant numbers of breaches. Of these, only professional services have a lower and less-skewed average breach cost. We will next consider the breached company's revenue size.



Source: NetDiligence® 2018 *Cyber Claims Study*

There are many more companies with less than $50 million of revenue than there are companies with billions of dollars of revenue, so it's not surprising to see fewer breaches for larger companies. Similarly, it's not surprising to see costlier breaches for larger companies, as they tend to possess greater sets of records and spend more to repair a breach and fortify against future breaches. But what if we tweak this graph to show breach costs as a percentage of annual revenue? It's important to note the orange bar will no longer be the median breach cost but the maximum breach cost from the NetDiligence data set.



Source: NetDiligence® 2018 *Cyber Claims Study*

This graph illustrates the significance of breach costs for companies of various revenue sizes. For all company sizes, the average breach cost is small in comparison to their total annual revenue. What stands out most is the impact of the largest breach cost in the NetDiligence data set for companies with less than $50 million in annual revenue: 30 percent of annual revenue. This emphasizes that, while a data breach is a significant issue for any company, its cost could be catastrophic for a smaller company that could be less familiar with the various avenues to insure or otherwise transfer cyber risk exposures.

It can be daunting to compare various commercial insurers' offerings in the new and quickly evolving cyber risk market. When it comes to coverage limitations and sublimits in particular, it can be difficult to answer in advance the question of how the policy will respond in the event of a claim. This may point to an opportunity for the captive insurance market to step in, along with an actuary who can resolve the cyber risk data dilemma.

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.

2019 World Captive Forum

Captive Insurance Company Reports
April 2019

Editor's Note: We are fortunate to have reporting on the forum from several *CICR* associates, **Hugh Rosenbaum, Rachel Moir,** and your Editor. Your Editor has exercised his prerogative and, in some cases, combined, redacted, and refined the reporting of the individuals. The overall flavor is his.

The preconference workshop was a full house of about 80 people, which is pretty good at a golf resort. There was much discussion about domiciles, onshore and off, with observations by the panel on differences.

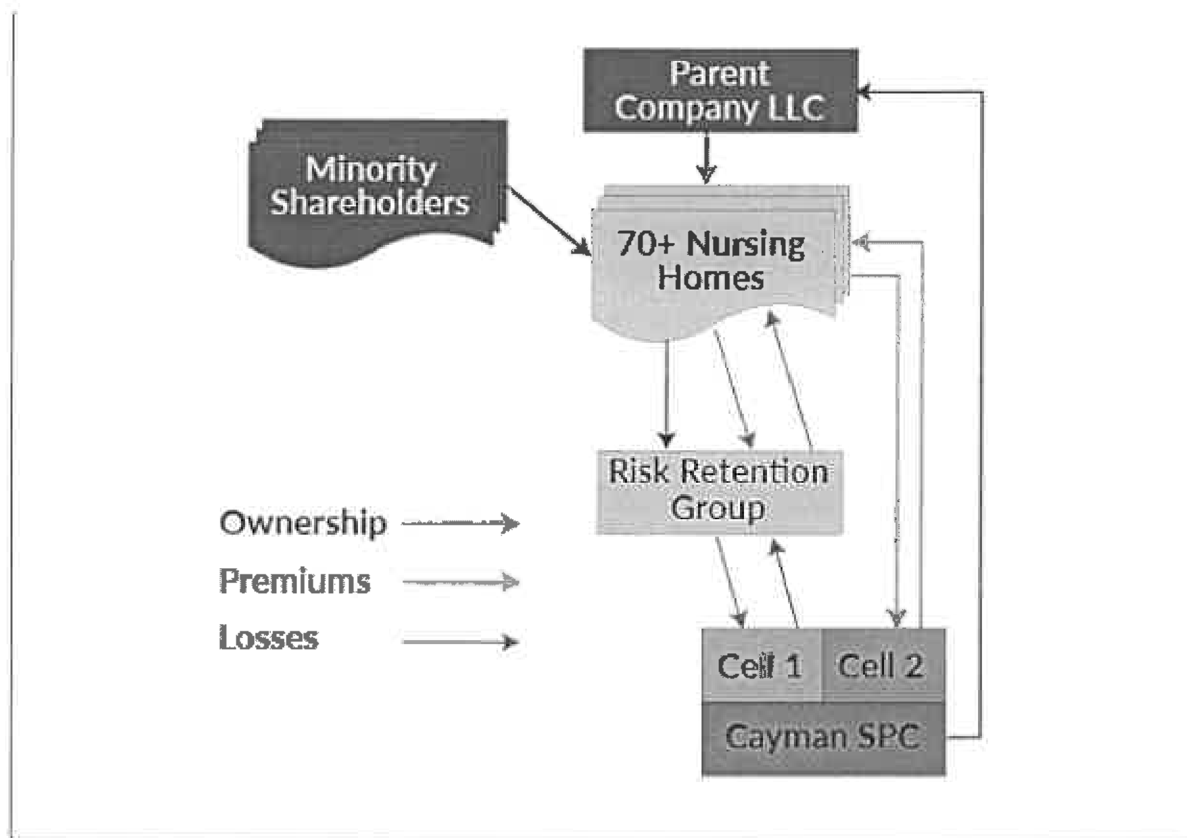
One presentation at the preconference "college" was interesting. The following example was provided.

A private family owns 70 nursing homes, many of which have minority ownership by others. They are spread over 15 states in the East. The client was fed up with the volatility of the professional liability market, looking for a more stable way to cover the workers compensation high deductible program, general liability, the umbrella liability, and medical stop-loss.

They formed a risk retention group (RRG) in Vermont for the liability lines and obtained a rating from Demotech for US Department of Housing and Urban Development purposes so that they could write direct.

Then they created two cells in Cayman since the minority shareholders didn't want to cooperate with taking the whole retention risk. Then, 95 percent of the professional liability lines were reinsured to cell 1. The other lines, workers compensation, general liability, and stop-loss, were reinsured into cell 2, with no minority shareholder involvement. The use of cells behind an RRG to satisfy different interests of different shareholders is instructive. An outline of the program structure is shown below.

CASE STUDY—NURSING HOMES



The above graphic is reproduced with the permission of Hugh Rosenbaum.

The IRS Influence

One of the main themes running through this year's conference was that of economic substance. This simply means the threat that all captives, including offshore captives, will have to show the existence of employees and functions—in-house. The general message we heard in several sessions was that outsourcing and control framework for outsourcing would prevail as satisfying the substance criticisms.

This theme reflects the main points of some recent Internal Revenue Service (IRS) court victories in cases, both onshore and offshore, where the economic substance of the entity was deemed by the IRS as failing.

Another theme was the conflicting opinion about a reduction in the growth of captives, or on the other hand, the increase in size and volume of the existing captives. Since the delegates were about 70 percent service providers, the atmosphere was optimistic.

This theme reflects the great slowing in the formation of 831(b) captives following some IRS wins but also the view of many at the forum that small captives aren't as important as big captives and that big captives should be formed and run offshore.

The Tax and Regulatory Session

This was the first year that international regulatory and compliance issues came up in several sessions, not just one on Solvency II (which was almost never mentioned this year). The panel for this session was composed of **Charles M. "Chaz" Lavelle**, senior partner at the law firm Bingham Greenebaum Doll LLP in Kentucky; **Dan Kusaila**, an auditor with Crowe in Vermont; and **Tom Jones**, a partner at McDermott Will & Emery LLP in Chicago.

This session was well-attended and started off by focusing on revisiting the *State Bd. of Ins. v. Todd Shipyards*, 370 U.S. 451 (1962), case (See "Tax Factors: Self-Procurement Taxes," April 2002, and "Captives: Creeping State Tax Reach," October 2010) in which taxpayers resisted the application of Texas self-procurement tax—but in 2010, the Dodd-Frank Act raised the profile of the self-procurement tax. Headquarter states began looking for tax income and imposed a self-procurement tax.

Tax Reform Act Points

The new flat corporate 21 percent rate will adversely affect 831(b) captives because they will be liable for the higher rate instead of the lower 15 percent they had been paying.

The *dividends received* deduction rates were reduced from 70 percent to 50 percent and from 80 percent to 65 percent. These offset the effect of the reduced corporate tax rate.

There is now a less favorable treatment of loss reserves. The discount factor has been changed to 3.12 percent to result in less of a deduction. And, one must use industrywide rather than company-specific pay-out patterns.

Effect on Captives of Lower Tax Rate

One of the advantages to captives is in accelerating the deduction for unpaid losses. Many thought that the lower tax rate would discourage captive owners and cause them to close captives. **Tom Jones** said that he sees no captives being closed down for that reason solely. He also said that he had spent more time advising on passive foreign investment company issues than all other topics recently.

Audits

The IRS is now focusing on smaller companies, especially 831(b)s. Mr. Lavelle said that if the IRS wins on those, the audit changes will apply to larger companies.

Small captives—831(b)s—have been a new focus for the IRS because they are not sure which are operating correctly under the laws. Since they profess not to know, they required collecting all the info from all of them in 2016. In spite of this, no guidance has been forthcoming. And there have been class actions against promoters of small captives by unsatisfied smaller owners.

Pooling is a common practice among these small captives. The following is the panel's advice for taking the defense against a tax attack.

Pooling Considerations

Accordingly, the following seem to be a number of factors discussed by the court (some of which overlap) to which one should give thought.

- Actuarially determined premium (calculated separately for each insured)
- Compliance with regulatory requirements
- Minimum capital
- License to do business
- Credit risk of pool participants
- No provisions that significantly affect economics, etc.
- Limitation of loss to an amount equal to amount recouped for ceded loss or a similar provision

Regulatory

Because of the pronouncements of the Organisation for Economic Co-operation and Development and other international bodies, offshore captive meetings now spend a lot of time on framework requirements. The latest one is the risk management framework in which the major risks of the captive itself have to be reviewed and mitigation discussed. The same sort of requirements come into play for the corporate governance framework and now an outsourcing framework.

Country-by-country reporting is going to be required for companies with over $850 million in revenues. There is a requirement for reporting to the tax information entities in each country. The intent is to discourage the use of low-tax jurisdictions to house profits where there is little activity.

> The playing field is tilting in favor of US onshore domiciles because of all these.
>
> — Source: Chaz Lavelle, Dan Kusaila, and Tom Jones, Tax and Regulatory panel, World Captive Forum 2019.

CICR comment: Actually, the playing field has long tilted significantly toward onshore for many other tax and convenience issues.

Cell Structures Session

Kevin Doherty, Dickinson Wright PLLC in Nashville; **Courtney Claflin,** executive director of the captive insurance program at the University of California, Office of the President, San Francisco; and **Nicholas M. Frost,** Quest Captive Management in Bermuda, made up the panel discussing cell captive structures.

Tennessee and several other domiciles don't license individual cells. But their business plans may have to be *authorized*. There are about 450 separate cells in Tennessee alone. Mr. Doherty estimates that in US domiciles there are another 1,500 or so.

CICR comment: Combined with offshore cells, that could bring the total number of cells up to 5,000.

Mr. Claflin explained how the massive University of California system uses cell captives. Its exposures are as follows.

- 3 national laboratories
- 5 academic medical systems
- 10 university campuses
- 280,000 employees
- 375,000 students
- $36 billion annual revenues
- Sports teams, stadiums, airplanes, airports, foreign ... everything imaginable

Mr. Claflin said that the university uses cells because, generally, cells are helpful whenever it is desirable to separate risk and ownership without full-blown captive licenses.

He explained that the program uses pools of all sorts.

- Cell A insures all directly, and each other cell reinsures with cell A.
- Each cell insures its owners, and each cell reinsures with one or more other cells.

Types of programs at the university include the following.

- Loss of professional license
- Medical professional liability
- Medical stop-loss
- Coastal property insurance
- Title insurance

The Challenge of Harnessing Data within Healthcare Liability Captives

Breaking down claims data silos to bring various data sets together in healthcare systems requires a systematic approach according to a panel of experts who spoke at the 2019 World Captive Forum.

Robert Hanscom, vice president of business analytics at Coverys, said that there is much talk and commotion surrounding "big data." With big data, he said there is a need to have well-organized, actionable data where everyone can work together.

At the same time, according to **Michael Maglaras,** principal at Michael Maglaras & Company, healthcare organizations and their captive insurers will be increasingly involved with lawsuits related to societal issues, the kind of issues that are currently saturating media headlines where the resulting claims have nothing to do with clinical outcomes. For instance, as our nation faces the opioid crisis, what effect will lawsuits against "Big Pharma" have on acute-care facilities? Or how will captive insurers be affected by the sexual misconduct era in which we live?

The new underwriting challenges are the increasing social risks that are generating claims for sexual abuse, opioid misuse, and the kinds of claims that have little to do with clinical outcomes and everything to do with social pressures.

Healthcare systems employing physicians mean that the captives behind them are getting bigger, and the pool of separately insured physicians is getting smaller, according to Mr. Maglaras, who predicted that the soft market would continue "forever," in spite of which medical malpractice captives will still be relevant.

Big Data

Captives have loss data of one kind or another going back decades. One captive's claims-made policy has a retro date on each policy as far back as 1987. Captives, who control up to 70 percent of all the healthcare liability insurance in the United States are starting to realize the significance of this data and how to apply it, not just for rating and financial purposes but for improving the behavior of the individual physicians and administrative staff. Captives are in a better position to compare and share aggregate data with others since, unlike commercial insurers, they aren't competing with each other.

Captives are sources and repositories of all the data mentioned above. By using captive data analytics, more can be done at the complaint stage before claims escalate to litigation. This is what healthcare captives can teach the commercial market. As if to underscore this point, Mr. Hanscom explained that Coverys started out as a captive, a medical mutual, and is now a successful commercial insurer of physician and hospital medical malpractice.

Actionable Claims Data

Mr. Hanscom said that captive insurers will need to take medical malpractice data out of the media headlines to identify "root cause indicators" and "root causation factors" to generate actionable data. However, he said the fact is that the headlines provide just one small data set, where the bigger data are what happens in the day-to-day healthcare environment and the subsequent centralization of these data.

Medical malpractice data should not be merely "one drop" but instead a starting point for thinking about related issues, according to Mr. Hanscom. For instance, the net of related issues includes adverse events and root cause analysis cases (a subset of adverse events). There are also patient complaints and "human" interpretation of outputs that are derived from information intelligence, he explained.

Concerning medical malpractice claims, Mr. Hanscom said big data encompasses countrywide medical malpractice data that is currently fragmented, where different parties hold tightly onto their own data—even within organizations. He advised that often, serious issues are discovered by accident and that such issues should not merely present themselves "just because someone asked." Instead, he said there should be a systemic approach to bringing various data sets together.

Furthermore, there is also data that inform population management, said Mr. Hanscom. The issue with this, he explained, is that, again, most healthcare systems view these claims data in fragments. What we need to consider is how to link these data sets together to go further in informing healthcare organizations.

Mr. Maglaras emphasized that when a medical error happens at the practitioner/nurse level that costs lives and makes the headlines, you can bet that a healthcare organization's captive board of directors will ask how it happened and how it can be fixed. According to Mr. Maglaras, the way it gets fixed is because a piece of captive claim information percolates up in ways that affect people's pockets.

The new board meetings are all about claims. "It's not the same old annual meeting," said Mr. Maglaras. The CEOs and chief financial officers, in their capacity as board members, now want the whys and facts of large cases and trends. Increasingly, the chief medical officer and the quality control chief are invited to captive board meetings.

In an example, he described a routine situation that happened almost 20 years ago where a patient who required a blood transfusion died because she was given the wrong blood type. At that organization's captive board meeting, a decision was made that affected how things were done on the ground level.

Bringing the example forward to the realm of "big data," Mr. Hanscom said that this type of information is called "signal data." He said that since the medical malpractice data set is small, it often reflects the "worst of the worst." Therefore, in Mr. Maglaras's example above, once a case like this emerges, this "type" of information should be communicated back to the organization and the healthcare system as a "signal" and then examined to determine if it is a systemic issue that could happen again, according to Mr. Hanscom.

He added that signal data can be strong, weak, or moderate. When there is a strong data signal, he said, "It should always be posed back to the healthcare system [to ask questions that ultimately] assess whether or not the vulnerability is still there. That's really the goal. That's what makes this data actionable."

Balance Sheets

Mr. Maglaras emphasized that, since the early 1980s (even as far back as the late 1970s), these data have existed on the balance sheets of captive insurance companies who have literally been capturing these kinds of data for decades. However, we are not using this data, he said.

"What do Slovenia, and Cuba, and Italy, France, and Costa Rica know about delivering babies that we don't?" he asked. "Our maternal and fetal death rate is higher than theirs. We have the data, it's in captives, we're just not using it."

Breaking Down Silos

When asked about the obstacles to breaking down silos and how to address issues surrounding medical malpractice claims data fragmentation, Mr. Hanscom advised that tackling some of the challenges simply involves observing how medical malpractice claims data are collected and "paid attention to." He believes this involves the following.

- Getting claims files well organized, starting with a shared taxonomy that is used to code claims data.
- Performing a root cause analysis on claims files that identifies causation factors, regardless of the claim's outcome, to describe why a claim was brought in the first place.
- Once a systematic approach is applied to multiple years of claims, an organization can start to harness "claims intelligence."

A centralized environment with one taxonomy allows for a bridge between data sets. Using the same codes for the same types of cases would give healthcare systems a centralized view of data, he explained.

Mr. Maglaras emphasized, "You want to go into a healthcare system and get a high quality of care, and that healthcare system has access to data to improve [your] care through a captive, and they are still not using it."

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.

Corporate Regulation and Governance in Captives—Survey Observations

Captive Insurance Company Reports
April 2019

Editor's Note: **Derick White**, managing director of corporate governance and regulation for Strategic Risk Solutions, continues his observations on the survey about how to run a captive. In "Survey on Corporate Regulation and Governance in Captives" (February 2019), he provided the findings. Here, he offers comments on the results. Contact him at derick.white@strategicrisks.com.

In 2018, Strategic Risk Solutions and International Risk Management Institute, Inc. (IRMI), conducted a survey to determine the extent of corporate governance that some captive insurers, risk retention groups (RRGs), risk pools, and commercial insurers have in place. The survey compiled responses by 195 officers and board members. The overall survey results were provided in February, and now we discuss the findings in more detail.

The Reasons Behind the Questions

Corporate governance has received a lot of attention in the past few years, and the field has grown to be rather confusing and hard to define, with many experts weighing in, and explains why the survey questions were posed. Simply put, governance can be defined as the set of guidelines established by the board and management to follow in running the company. To discover how it works in actuality, the survey divided corporate governance into three sections.

- Framework
- Policies and procedures
- Accountability

Think of these as the "good," "better," and "best" practices. Implementing all three is necessary for corporate governance to be considered complete.

Framework

Framework constitutes the fundamental operations of a board, established at the first board meeting that adopts the company bylaws. This includes the size of the board, frequency of meetings, term limits for directors, whether to include independent directors, and the number of committees. For many captive insurers, these bylaws are drafted by outside counsel using a best-practices template. Often, they are adopted without much thought, as more pressing needs—such as issuing policies and establishing operating policies—take priority.

Policies and Procedures

Policies and procedures include documentation of ideas and reports that are usually generated after the company is up and running. These policies generally address ethics, internal controls, the company's business plan, strategic objectives, and a formal succession plan for directors and management. These take time to develop and are usually considered after day-to-day operational needs are met.

Accountability

Accountability looks at the board performance, including discussions on how to make the board even better. Discussions include considering the competencies and skills of current board members and what is missing, educating the board, evaluating senior management, and meeting with shareholders. This section is often overlooked; however, corporate governance mandated by regulators has many commercial insurers and RRGs beginning to consider it.

Framework Data Analysis Survey Results

Now we take a look at certain aspects of the survey results we found particularly interesting. For overall data results, see the article in the February 2019 edition of CICR.

Scheduled Board Meetings

All boards meet at least once a year; most meet annually. This is not surprising as many single-parent captives meet once a year to comply with domicile guidelines.

- 62 percent of pure captives meet annually
- 20 percent of group captives and commercial insurers meet annually

To stay informed, boards should meet more frequently. Even a teleconference to review the standing of the company could spur meaningful conversations, leading to more timely decisions.

- 47 percent meet annually or monthly
- 53 percent meet quarterly or some other time frame

Of those meeting monthly, 3 were RRGs in operation for less than 5 years, and the other was a commercial insurer operating for more than 15 years. There is probably a specific reason for these few companies to meet monthly.

Board Size

- 53 percent reported having 4–7 directors
- 24 percent reported having 8 or more directors

We give good marks to survey respondents relative to their board sizes. It can be argued that between 4 and 7 directors is best to encourage active discussion. Fewer may not provide the diversity of background, and more could be cumbersome or lead to groupthink, with the board following the loudest members. Those with large boards were a mix of pure and groups generally having been in business for over 10 years.

Term Limits

- 32 percent reported having term limits and/or staggered terms for directors
- 83 percent of pure captives do not have term limits for directors

Often, directors of pure captives consist of representatives from the parent, including the risk manager, internal legal counsel and/or treasury, and a local domicile resident who could serve as the manager. These representatives plan to serve as long as they are employed by the parent company; they may not wish to think about limits.

Independent Directors

- 63 percent have some independent directors on the board

As expected, group captives and commercial insurers have more independent directors than single-parent captives. Independent directors add a niche experience as needed and increase accountability as they are, by definition, independent. Defining "independent" was difficult as some would include the captive manager as independent, while others would only include nonmanagement and nonservice providers or vendors.

Standing Board Committees

- 55 percent of nonpure captives have more than 1 committee
- 68 percent of single-parent captives reported having no committees

These standing committees included audit, investment, underwriting, claims, executive, risk, and governance. Committees can be made up of board members with specific expertise in a particular area, management, and potential board members appointed, in part, to learn about the company. This allows for more in-depth discussions at the committee level and more general discussions at the full board level.

Summary

Overall, the framework survey findings show that a foundation is in place for most respondents. Many companies have a good working number of directors and meetings but should consider whether term limits, independent directors, and the establishment of committees would benefit the board.

Policies and Procedures Analysis Survey Results

Boards often focus on the past quarter financial results and do not consider how the company stands looking to the future. Yet, the board is there to guide the company into the future while considering risks and opportunities. Developing "formal" policies and procedures means the board has discussed, voted on, and documented its policies and procedures—a good thing.

Ethics

- 69 percent of all respondents reported having an ethics policy
- 59 percent reported annually reviewing and affirming the ethics policy and performance

Ethics policies are important as they provide a foundation on how the board expects itself and the company to be run. Having an ethics policy is now mandatory for RRGs, required by the model risk retention corporate governance act adopted by the states. The survey reported all but one RRG have a policy in place, with this one stating it did not know whether a policy exists.

Business Plan

- 69 percent reported they review the business plan as a specific agenda item
- 23 percent reported that they informally review the plan
- 8 percent said they do not review the business plan

One of the most important board functions is to know and understand the company's business plan and where the company is headed strategically.

- 96 percent are aware of the company's strategic vision
- 3 percent reported that this topic hasn't come up

Of those who are aware, half of the respondents said that the board discusses the organization's strategic direction annually, and half said that management keeps the board up to date. This was a bit of a trick question as the board is responsible for choosing where the company is headed strategically. Management's role is to use the board's guidance in steering the path.

Accountability Analysis Survey Results

Accountability has to do with the board taking an active role "in itself." The board must consider its own makeup in terms of skills, education, experience, independence, diversity, a succession of members, and its relationship with the shareholders. The board must ensure that its own makeup is as good as it can be—now and in the future.

- 62 percent said their board had not formally considered board makeup (74 percent of pure captives)
- 32 percent of respondents reported that they have considered board makeup, either as a separate agenda item or during a strategic planning session
- 5 percent used a third-party consultant to help in considering the board makeup

To obtain broad information when considering decisions, the board must be diverse. This means the board should seek to have directors with varied education and experience. Insurance companies should consider members with financial, underwriting, legal, human resource, and other backgrounds for filling board positions.

Education

- 59 percent reported no formal education is provided to the board and/or new board members
- 22 percent offer to cover conference costs for interested board members
- 19 percent have a formal education plan

Budgets are tight, and time is short for many boards and board members. However, as management is expected to keep up to date on current issues, the board must also set an example by remaining educated.

Self-Evaluation

Part of accountability is evaluating oneself. Formal policies and procedures are vital in establishing the board's tone and helping to ensure consistency and continuity. The survey asked whether an annual board and committee evaluation process is in place. Respondents revealed that boards review the company's business plan periodically, and some also review where the company is headed strategically.

- 77 percent reported no annual board and committee evaluation process
- 23 percent evaluate just the chair and the CEO or the chair, CEO, and the board

Surprisingly, 59 percent of RRGs responded that they do not have a board evaluation process in place, despite a requirement to do so by the RRG Corporate Governance model act adopted by states.

Shareholder Meetings

- 57 percent of respondents meet formally with shareholders

- 9 percent meet with shareholders through social gatherings

As the board does report to the shareholders, it should have an open and approachable relationship with them. Such meetings are critical to accomplishing this goal.

Conclusion

The survey found that all companies have some components of corporate governance in place. Some meet only the minimal requirements, assembling just once a year. Others discuss where the company is headed, and a few go as far as evaluating their own performance.

Corporate governance opportunities can be overwhelming. This survey was intended to break governance down into smaller pieces that can be managed and to make it easier to start discussions. It is hoped that this survey and discussion will encourage more directors to review their own performance and what can be done to move from good to better to best.

Looking Ahead
Next month, we will have more on the World Captive Forum and domicile updates, including North Carolina and Utah.

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.

Captive Insurance Conference Calendar

Captive Insurance Company Reports
April 2019

CAPTIVE INSURANCE CONFERENCE CALENDAR		
Date	**Conference**	**Location**
Mar. 10 –12	Captive Insurance Companies Association (CICA) International Conference	Tucson, AZ
April 23	DC Captive Insurance Domicile Showcase	Washington, DC
May 7–8	DCIA 2019 Spring Forum	Wilmington, DE
May 20 –22	Western Region Captive Insurance Conference (WRCIC)	Scottsdale, AZ
May 21	Connecticut Captive Insurance Association 2019 Annual Collaborative	Hartford, CT
June 10 –12	2019 Bermuda Captive Conference	Southampton, Bermuda
August 5 –8	Vermont Captive Insurance Association (VCIA) 2019 Annual Conference	Burlington, VT

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.

Editors and Contributors—April 2019

Captive Insurance Company Reports
April 2019

CICR is published in association with Willis Towers Watson. For subscription questions or problems, contact IRMI customer service at (800) 827-4242 or www.IRMI.com. For information on Willis Towers Watson, visit www.willistowerswatson.com/.

Editor: **Michael Mead**

Editor Emeritus: **D. Hugh Rosenbaum**

Contributors: **Jon Harkavy, Aaron Hillebrandt, Derick White**

Opinions in this report on financial, tax, fiscal, and legal matters are those of the editors and others; you should obtain professional counsel before taking any action on the basis of this material.

Captive Insurance Company Reports—Copyright 2019 by International Risk Management Institute, Inc., 12222 Merit Drive, Ste. 1600, Dallas, TX 75251-2266, 972-960-7693. ISSN 1537-3460. All rights reserved. This material may be quoted or reproduced only with permission in writing from the publisher. Website address: www.IRMI.com

© 2000-2019 International Risk Management Institute, Inc. (IRMI). All rights reserved.