



2021

Fall Forum

Should Captive Managers be Subject to Regulatory Oversight?

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In recent years the captive industry has faced challenges from regulatory intrusions by the IRS, legislation on Capitol Hill, the state legislatures and the courts.

Should Captive Managers be Subject to Regulatory Oversight?

Yes? | No? | Not Sure?



If Yes – Why?

- To encourage captive managers and other industry participants to continue to abide by the highest ethical standards
- Offering readily available standards for policymakers and regulators
- Providing a professional and ethical differentiator
- Offering a needed level of uniform professionalism to the industry.
- Helps build trust –
 - To clients / prospective clients

If Yes, Who or by Whom?

- IRS?
- NAIC?
- State insurance bureau – where captive manager is approved?
- Industry SRO?
 - “National Association of Captive Managers”



What is the role of a captive manager?

The Captive Manager is a private sector insurance consultant and service provider the regulator relies upon to:

1. Serve as a knowledgeable intermediary between the regulator and the captive insurer's owners (whose expertise lies in some other industry);
2. Monitor the affairs of the captive insurer on behalf of the regulator;
3. Educate and orient the captive insurer's owners, directors and officers with respect to owning and operating an insurance company;
4. Justify a more relaxed and flexible regulatory regime for captive insurers; and
5. Promote the development of the state's captive insurance industry.

What do state regulations (laws/statutes) say about approving captive managers?

Most state captive insurance laws commonly describe the required qualifications to serve as Captive Manager in broad terms of possessing sufficient; "competence," "experience," "character," and "reputation."

Some captive domiciles have a "pre-approval" process – considered a quasi-licensing process, that includes:

- Having a prospective captive manager submit an application and supporting materials attesting to the merits of their skills.

What do state regulations (laws/statutes) say about captive managers responsibilities? (*one of two*)

To the extent addressed at all in the law itself, most states captive laws specify that the Captive Manager is required:

1. To maintain the captive insurer's books and records at a location in the state of domicile,
2. To promptly notify the Commissioner of any failure of the captive insurer to comply with the applicable captive law, and
3. Serve as a knowledgeable intermediary between the regulator and the captive insurer's owners (whose expertise lies in some other industry);

What do state regulations (laws/statutes) say about captive managers responsibilities? (*two of two*)

Additionally, many domiciles have issued regulatory bulletin that further describe a Captive Manager's responsibilities in greater detail, as follows:

- Maintain a place of business for the captive insurer in the state
- Maintain and make available for inspection by the Commissioner copies of the books and records of the captive insurer
- File statutorily required reports on behalf of the captive insurer
- Obtain prior approval from the regulator prior to implementing material changes to the captive insurer's plan of operations
- Notify the regulator promptly if the captive insurer is out of compliance with financial requirements or evidences another adverse financial condition

Aside from captive laws, regulations and bulletins, Captive Managers commonly fulfill the following functions:

- To actively promote the captive domicile and attract captive insurer applicants
- To consult with prospective captive owners in the development of their business plans
- To work with insurance intermediaries for the purpose of obtaining fronting and reinsuring (when applicable)
- To formulate and shepherd the captive insurer's application for certificate of authority
- To recommend other professional service providers, such as attorneys, auditors/accountants, actuaries, underwriters/administrators, risk managers, adjusters, investment managers, bankers and others
- To coordinate the captive insurer's use of professional service providers
- To provide administrative support to the captive's board of directors or other governing body
- To actively monitor the captive insurer's ongoing regulatory compliance
- Notify the regulator promptly if the captive insurer is out of compliance with financial requirements or evidences another adverse financial condition

What powers do Captive Regulators possess to regulate Captive Manager's?

- The Captive Manager Application – The information included in the application effectively constitutes the regulator's articulation of the information it considers relevant for purposes of assessing whether a proposed Captive Manager is sufficiently "competent," "experienced," "reputable," etc.

However (there's always a "but"),

Any process for approval of Captive Managers creates the possibility of denial and termination of approved status. In fact, the captive insurance laws of many domiciles grant the regulator express authority to withdraw or terminate the approval of a Captive Manager.

For example – 1:

Arizona law provides that "[t]he director may require a captive insurer to discharge a captive manager for failure to substantively fulfill the captive manager's duties under this article."

A.R.S. § 20-1098.16.

What powers do Captive Regulators possess to regulate Captive Manager's?

For example – 2:

The South Carolina bulletin 2008-03, pp. 6-7 provides that the regulator may withdraw or suspend approval of a Captive Manager if:

- "The captive manager knew or should have known the officers or directors of the company were engaged in any conduct that...violated state or federal laws or engaged in any conduct that would otherwise threaten the solvency of the captive insurer and failed to report such conduct to the Department in a timely manner."
- "The captive manager knew or should have known and failed to inform in a timely manner, the captive board of directors and the director of insurance of actions...leading to revocation or suspension of the certificate of authority..."
- "The manager failed to perform the basic manager responsibilities or reporting requirements..."
- "The captive manager engaged in conduct detrimental to the interests of the captive insurer, including but not limited to, conduct that constitutes a breach of the fiduciary duty owed to the captive insurer or a conflict of interest."

What remedies do Captive Managers have in cases of Suspension or Termination?

- A termination would most likely fall under general principles of administrative law and could constitute agency actions that should be subject to appeal on the grounds of being unauthorized, arbitrary, capricious, or an abuse of discretion.
 - From both a practical and legal perspective, it would be difficult for the Captive Manager to successfully challenge the regulator's decision that a proposed Captive Manager is not sufficiently "competent," "experienced," "reputable," etc.
 - However, after the regulator has approved a Captive Manager, without rejecting a proposed Captive Manager, the regulator's withdrawal or termination of that approval should be more susceptible to administrative challenge.

Most likely scenario?

The most likely scenario for the regulator to withdraw or terminate its prior approval of a Captive Manager is the allegation that in its conduct as Captive Manager after initial approval, the Captive Manager failed to perform in accordance with the requirements set forth in the applicable captive insurance law or other guidance.

Grounds for Withdrawal or Termination?

- Filing an incomplete or untruthful application for authorization
- Conviction of any felony
- Fraudulent or dishonest acts while performing management services
- Gross negligence or breach of fiduciary duty
- Misappropriation of client assets
- Knowingly filing a false or fraudulent annual report or other report of a client
- Willfully failing to file an annual report and/or communicate circumstances of any filing delays
- Failure to timely notify of a client's unauthorized withdrawal, insolvency or impairment of assets
- Obtaining fees under a contingent arrangement (e.g. amount is dependent upon specified finding or result)
- Disclosure of confidential information pertaining to a manager's clients obtained in the course of performing management services
- Advertising or solicitation using false, fraudulent, misleading, deceptive, or unfair statements or claims
- Any professional conduct or ethical behavior determined by the Commissioner to be unbecoming of a Captive Manager



Best Practices – Resources for Captive Manager’s

- Codes of Professional Conduct –
 - SIIA
 - North Carolina
 - South Carolina

Generally, these cover certain basic Canon’s, including:

- Integrity
- Conflicts of Interest
- Confidentiality
- Advertising
- Practice Management

Something to Think About



- Should Captive Managers be regulated?
- Should captive domiciles have, at a minimum, a Code of Conduct (or adopt SIIA's)?
- Should Captive Manager's have to agree to abide by a Code? – in writing?
- Do domiciles need to amend their captive laws in order to give regulators more authority to oversee Captive Managers?
- If so, can/should domicile associations have a seat at the table?
- Should domiciles require an annual renewal application for Captive Managers – information that may change from year-to-year (e.g., number of captives managed, staffing, business insurance, relationships, services, etc.)?
- Should seasoning requirements be part of the Captive Manager approval process (e.g., prior experience or operating history in insurance or related activity)?
- Should credentialing and continuing education be required for Captive Managers?
- Should Captive Managers be required attend a minimum number of captive conferences to maintain approval status (e.g., State associations, SIIA, CICA, RIMS, etc.)?



THANK YOU

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