CAPTIVE MANAGER LICENSING: WORTH THE COST?

Michael Corbett, Nate Reznicek and Robert Walling explore whether additional captive manager licensing would raise standards or simply impose regulatory burden

There continues to be rancorous debate regarding the need and potential value of captive manager licensing and credentialing, as well as debate regarding possible approaches to credentialing captive managers. This article will try to provide a systematic examination of the pros and cons of three different approaches to licensing captive managers – maintain the status quo, pursue an National Association of Insurance Commissioners (NAIC)-based licensing model, or utilising a credentialing organisation such as the ICCIE. We will not advocate any of these approaches or take a position of advocacy. However, we do suggest that the captive management industry will be better served if they take a position before one is taken for them.

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Why does this matter?

It is instructive to consider the scope of work performed by captive managers. Captive managers are responsible for creating a captive insurance company's financial statements. They regularly interface with all the captive's other licensed professionals as well as the captive's regulatory domicile.

Most captive managers provide coverage advice, draft policy and reinsurance agreements, negotiate claim settlements and adjudicate claims for transactions that are typically in the hundreds of thousands of dollars or more. If a captive manager was a lawyer drafting policies, a claims adjuster handling claims, a reinsurance intermediary designing the reinsurance, or an insurance agent advising on insurance program design, that manager would be required to be licensed.

It seems counterintuitive that one would need to obtain and maintain a license to sell/service commercial insurance through the standard market, but is somehow exempt when the insurer/reinsurer is owned by an affiliate of the insured(s). How can it be that one's cosmetologist (assuming one had one) has more stringent licensing and continuing education (CE) requirements than one's captive manager?

An iron fist in a velvet glove?

In most US captive domiciles, captive managers, actuaries providing loss reserve opinions and certified public accountants serving as captive auditors must apply to be accepted onto approved lists in order to provide services to captives. These approved lists are similar to, but far less rigorous than, a state's licensing of insurance agents, healthcare providers, lawyers, accounting professionals and other professionals.

When asking captive regulators about the current approach to regulating captive managers, one common theme is that regulation starts with the captive. The response from one domicile indicated they try to avoid difficulties by not licensing

problem captives, including those with captive managers they are uncomfortable with, in the first place.

The regulation of the captive and captive managers continues as the captive operates. One regulator noted that the ongoing regulation of captives provides valuable information about service providers. They said: "The [captive financial] exam process is revealing a range in the quality of work that is enlightening. We have worked with several service providers who have provided less-than-satisfactory work product by actively communicating our expectations of them to improve their work."

Another regulator added: "For already licensed managers, we review their compliance during exams." Again, it begins with captive regulation, but naturally leads to proactive service provider regulation.

The current approach can be quite effective in managing specific captives and captive manager situations. Advocates of the status quo also point to the success the current approach has had in regulating captive managers.

They also note that some of the worst offences in recent years have been committed by individuals who were not captive managers and would not have been affected by changes in captive manager licensing. Proponents of the status quo also note the substantial level of communication that exists between captive regulators today.

However, the current approach fails to provide: 1) more formal communication and coordination between domiciles; and 2) due process, appeals and a process for reinstatement for a disciplined captive manager. At a high level, it also lacks transparency to all parties involved, including other regulators, captive owners and the public.

Another notable problem that exists in some domiciles is regulators lack the statutory authority to remove a captive manager from the domicile's approved list. In other words, once a captive manager was added, it is difficult to remove them.

In recent years, some regulators have made the subtle but important change of removing the word "approved" from the service provider list to remove any suggestion that they are approved or recommended by the regulators.

As a result, expanded regulatory oversight and stricter licensing of captive service providers are real possibilities. One regulator provided some interesting perspective on where captive manager regulation could be headed. They said: "Because of the IRS's [Internal Revenue Service] position that many managers of 831(b) captives are promoters, I am hearing discussion about managers (being required to) become licensed producers/agents. This would allow states the authority to take action against managers under the existing producer licensing laws."

Characteristics of effective captive manager licensing

What characteristics would be necessary for an effective approach to captive manager licensing? First, any captive manager licensing approach should have broad applicability, ideally at least all US captive domiciles to avoid captive managers simply changing domiciles. In addition, the approach needs to provide due process, that is give some organisation the authority to investigate conduct, discipline captive managers, and provide both appeals and reinstatement processes.

There are two potentially successful approaches to developing a licensing process for captive managers: the establishment of a credentialling body, and the use of an NAIC model law. We will examine both alternatives.

Option 1: Credentialling body with disciplinary authority

The first viable approach to licensing captive managers involves the establishment of a credentialing organisation with both the ability to provide a professional designation and also the authority to have a disciplinary process. One such example is the Casualty Actuarial Society (CAS), which provides credentialling for property-casualty actuaries in the US. It also has the authority, in partnership with the Actuarial Board for Counselling and Discipline (ABCD), to discipline actuaries in violation of actuarial standards.

Importantly, the ABCD and CAS not only have the authority to discipline actuaries, but also undertake formal investigation, appeals and reinstatement processes.

The American Institute of Certified Public Accountants (CPAs) has similar credentialling and disciplinary authority for CPAs. The mandatory nature of these designations for certain professional activities helps ensure that all say appointed actuaries are subject to the CAS disciplinary process.

By contrast, an organisation like the International Center for Captive Insurance Education (ICCIE) has developed a rigorous education and credentialing process, but lacks both the regulatory mandate (ie. you are not required to be an associate in captive insurance, ACI, to be a captive manager) and also the authority to discipline ACIs. But what if they did have this?

As noted, the first approach to a formal licensing process for captive managers follows the approach used by CPAs and actuaries. Consider if an organisation with a credentialing programme, such as ICCIE or the institutes, added a disciplinary process that gave them the authority to investigate alleged violations of a code of ethics and professional standards, and due process for investigation, discipline, appeals and reinstatement. Captive regulators could require that every captive application name a credentialed captive manager (for instance, an ACI at the captive manager) who would have responsibility for the conduct of the captive manager relative to that captive insurance company.

Another approach would be to impose a level of credentialling at the captive manager level. Consider ICCIE's approach to listing ICCIE-trained organisations, where:

- **At least 20% of the captive professionals** in the organisation must hold the ACI in good standing; and
- **At least 30% of the company's captive professionals** must be ACIs, Certificate in Captive Insurance (CCI) holders, or currently enrolled in either the ACI or CCI programme.

Could captive regulators require captive managers to be ICCIE-trained organisations? Does that create a barrier to entry for smaller organisations? Does it create salary inflation for ACIs?

The biggest advantage of the credentialing association approach is taking advantage of the existing credentialing processes, such as the ACI designation. The biggest challenge is the need for captive regulators to require an ACI, or similar credential, on the captive application and recognise the credentialing body's authority to discipline members.

Option 2: NAIC model law/ regulatory approach

In 2005, the NAIC developed the Producer Licensing Model Act, which "governs the qualifications and procedures for the licensing of insurance producers". There are many aspects of this model act that

could either be expanded to include captive managers or imitated in a standalone model act for captive managers to provide regulators with guidance on captive manager licensing. For example, section 3 states that "a person shall not sell, solicit or negotiate insurance in this state for any class or classes of insurance unless the person is licensed for that line of authority in accordance with this act". Language such as this could be easily expanded or imitated.

The Producer Licensing Act requires passing a written examination (general and line specific), a written application, a background check, licensing fees and other requirements. It also contains specific criteria for license denial, non-renewal or revocation. The authority to do these things is conveyed to the insurance commissioner in the licensing domicile.

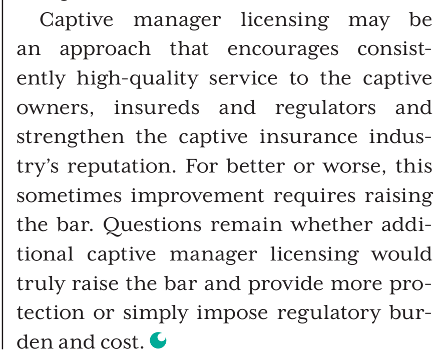
In short, captive management could almost be added to the Producer Licensing Act as a separate "Line of Authority" in section 7 and the act could be very easily expanded to include captive managers.

So, the Producer Licensing Model Act has already been adopted in all states, which simplifies expanding it to apply to captive managers. It also has the advantage of insurance commissioners already having substantial regulatory authority over similar professionals.

Perspectives on captive manager licensing

It is worth contemplating how all the different stakeholders in captive insurance might react to the addition of some form of captive manager licensing.

- **Captive managers:** Their reaction would definitely be a "mixed bag". It is wholly conceivable that some managers may view licensing as "raising the bar" and good for their, and the industry's, reputation. Others might view it as unnecessary, bureaucratic red tape that is contrary to the captive industry's well-known advantages of speed to market and ease of doing business. For this cohort, it may be said that, generally, there is tepid interest in changing the status quo. Would that change if several of the promoter cases or other litigation turns out badly? Or if more captive managers are sued for negligence by their captive owners, thereby publicly tarnishing the reputation of captive managers?
- **Captive regulators:** Again, we may assume that there would be a fair amount of support for the status quo. With regulators, there is often a pervasive attitude of "we'll catch any problems during the exam process". However, prior examples of known bad actors changing domiciles and engaging in questionable legal activities with new auditors, actuaries and regulators suggests that more transparency would benefit captive regulators.
- **Non-captive insurance regulators:** A number of domiciles that do not have captive legislation are openly anti-captive. Adding captive manager licensing, particularly an approach following the NAIC producer licensing model law route, would be viewed as a positive.
- **Complementary service providers:** Actuaries and auditors, especially those in smaller organisations, may not currently know the reputation of their new or prospective clients. That condition puts them at risk of engaging with potentially problematic individuals and organisations, and repeating mistakes of the past. More transparency would most certainly help this condition.
- **The IRS:** While not directly a stakeholder, the US tax agency has been proactive in pursuing captive managers that they view as promoters. Maybe some form of licensing would provide a venue for more self-regulation.
- **Captive owners:** They are, by far, the most important stakeholders in this discussion. They deserve transparency. That is, they have a right to know if a captive manager has been disciplined by any domicile or, just as crucially, their licensing organisation. Captive owners would never retain an actuary or auditor who was not a CPA or FCAS/ACAS. So, why would they hire a captive manager that wasn't qualified?



The ongoing interactions between captive regulators and their service providers are an important conduit to foster the captive industry's continuous improvement and uphold its reputation. Captive industry members have a vested interest in maintaining high standards for service providers and raising the bar as best practices evolve.

Captive manager licensing may be an approach that encourages consistently high-quality service to the captive owners, insureds and regulators and strengthen the captive insurance industry's reputation. For better or worse, this sometimes improvement requires raising the bar. Questions remain whether additional captive manager licensing would truly raise the bar and provide more protection or simply impose regulatory burden and cost.