

REDEFINING CAPTIVE SUCCESS

Flat line or flourish?

*What to do when your captive's financial
goals have been achieved.*

JUNE 2009

BY: BARRY COUCH, CIC, ARM



Are you accountable for the success of your captive insurance company?

This white paper is written for board members and executives who play a leadership role in the management of a captive insurance company.

If you hold yourself accountable, and are held accountable, for your captive’s success, the principles and strategies, and business model presented here, will assure a high degree of accountability and transparency to all stakeholders.

Years ago, we set out to discover ways to bring simplicity and order to what is quite often a complex and chaotic situation. What resulted is the formulation of a business model that utilizes an accountable and transparent process for building consensus among plan peers while enhancing the effectiveness of external advisors.

From the outset, we expected to be able to help managers and fiduciaries implement a strategic and practical action plan to assure the long-term, financial viability of their captive insurance companies.

As plan financial expectations were met, other unexpected, yet significant and valuable outcomes were achieved. The captives went beyond financial viability – the “flat line” as we now call it – and achieved ancillary financial and non-financial results. These benefits quickly became the dominant benefits, often to such a degree that owners and stakeholders redefined the captive’s over-arching purpose.

On a practical level, the process we developed identifies and separates the most relevant issues from those that are peripheral or even immaterial. This helps captives reduce dependency on commercial insurance and maximize the protection of assets. On a breakthrough level, it transforms the captive into a flexible, proactive and highly valuable strategic asset for all owners and related stakeholders.

Table of contents

	Page #
Executive Summary	2
The problem with flat lining	3
The captive as a strategic asset	5
Core strategies	
▪ Job #1: Financial viability without painting the captive into a corner	7
▪ Committed champions	7
▪ Accountability teams	8
▪ Taming elephants	9

Case Study #1: Lost beyond the business plan	10
Case Study #2: New beginning multiplies value and results	11

Executive summary

The flat line: What is it and why is it so wrong?

“The flat line” describes two conditions, one inevitably leading to the other.

The first occurs after a captive achieves financial viability and is a natural response to a job well done. When this happens, the captive’s progress flattens out and nothing else of much consequence is achieved.

The second is due in part to the inevitable erosion of a captive’s financial viability. As captive owners turn their attention to other matters, the captive becomes vulnerable to a much more critical and dramatic definition of “flat line”. Inevitably, some form of defining event or events occur and the captive suddenly faces a threat to its survival.

The captive as strategic asset

The telltale difference between successful managers and those whose captive has flat lined, is a willingness to always ask, “What else could we be doing?”

Strategic planners, who constantly answer the “what else” question, discover *the process of strategic planning is more valuable than the plan itself.*

Core Strategies

Supporting the concept of continuous strategic planning are four core strategies:

1. Job #1: Financial viability – the best results are achieved when captive owners use their own capital versus borrowing from a third, impartial party.
2. Committed champions – governing board and primary stake holders must go beyond committing their capital and invest their time, not only on the front end during the start up phase, but also on a regular, periodic basis.
3. Accountability teams – committed champions must take on active leadership roles in areas where they possess the appropriate skills, experience, and, most importantly, the desire necessary to succeed.
4. Taming elephants - when challenged, the most successful captives are able to draw on their collective wisdom, guiding principles, and fundamental strategies to achieve the ultimate goal.

The Flat Line

What is it and why is it so wrong?

In our introduction, we called the achievement of captive financial viability “the flat line”, a phrase we use to describe two conditions, one inevitably leading to the other.

The first condition occurs after a captive achieves financial viability and is a natural response to a job well done. When a captive has more assets than liabilities, its participants are buying re-insurance at or below market prices, and its reserves are at or above what the actuaries say they should be, congratulations are in order. But, this is the beginning of what could be the end as owners and stakeholders look only at financial measurements and assume the captive will *automatically* continue to be viable. When this happens, the captive’s progress flattens out and nothing else of much consequence is achieved.

The second condition is due in part to the inevitable erosion of a captive’s financial viability. As captive owners turn their attention to other matters – like running their businesses – the captive becomes vulnerable to a much more critical and dramatic definition of “flat line”. It may happen early on, or it may take many months but inevitably, a defining event or series of events occur, and the captive is suddenly faced with a threat to its survival. Those accountable for the captive’s viability not only have to take action, they may also have to rouse and demand a new course of action from passive and sometimes reluctant stakeholders and consultants.

There are many types of events and combination of events that can threaten and harm your captive. In addition to a lack of adequate attention or capacity to focus on captive tasks and responsibilities, captives suffer when:

- There is an absence of consensus on how much surplus to maintain and how best to allocate any excess funds;
- No or unclear policy for directing the minimum surplus to maintain;
- Thinking that the business plan used to create the captive will suffice as a longer term strategic plan;
- Weak leadership exacerbated by political issues;
- The captive’s performance is not measured against best practices, industry benchmarks and regulatory minimum standards;
- Coordination is lacking between advisors and consultants working in isolation;
- The natural tendency to over-complicate issues and opportunities is not held in check, and;
- Unanticipated boardroom surprises crop up (i.e. there are no policies or provisions in place to deal with issues such as member bankruptcy, claims volatility, re-insurer bankruptcy, regulatory issues and changes).

The Flat Line - continued

The repercussions of not properly addressing these challenges include:

- Stakeholder disenchantment and a related decline in program participation;
- Missing new opportunities to reduce expenses;
- Difficulty in accessing information;
- Confusing, inconsistent, untimely, incomplete and inaccurate information;
- An increasingly defensive and reactive advisory team that waits to be told to act or waits until others act;
- Inefficient spending on advisors;
- The lack of an effective accountability structure;
- A leadership vacuum among advisors: no single advisor has the vision, authority, and means to develop a strategic plan;
- A loss of direction and confidence among stakeholders;
- The purpose or viability of the captive being questioned by regulators (as they see capital grow beyond the captive's needs or, in worse cases, when they see under-capitalization);
- A return to dependency on the insurance carriers and vulnerability to fluctuation in premiums, and;
- An increase in risk due to a decline in the focus on safety and risk management in the captive.

Fundamentally speaking, if left unaddressed these issues lead to the perception that the captive is ineffective and more trouble than it is worth, which ultimately leads to failure – the permanent version of our flat line concept. With the failure of the captive comes the likelihood that the reputations of the participants will suffer, important relationships will be damaged, and stakeholder organizations will be harmed.

The captive as a strategic asset

Financial viability and beyond

We have learned that managers who act quickly to put in place a simple, organized, and effectively delegated strategic plan, are able to address the challenges created as their captive insurance company matures. These managers see the captive as much more than a short-term, tactical remedy to increased dependency on insurance companies or a handy self-insurance mechanism. Instead, they focus on the long-term viability of the captive and develop a strategic plan – beyond the original business plan – that includes initiatives such as capital risk financial planning, reducing employee injuries, and improving patient services.

The telltale difference between successful managers and those whose captive has flat lined, is a willingness to always ask and demand an answer to a simple question. In addition to, “How are we doing financially?” they ask, “What else could we be doing?”

While observing – and at times initiating – the asking and answering of this question, a breakthrough occurred in our understanding of how captives can flourish well beyond financial viability. At first we thought it was a matter of guarding against the ill effects of creeping complexity. And, while the pursuit of simplicity is vital, what is even more vital is the willingness of captive managers and stakeholders to engage in an ongoing dialogue the goal of which is to answer the “what else” question.

If you find yourself thinking the breakthrough we are reporting on is only the result of strategic planning, you are right... partially. Accepted thinking about strategic planning sees the plan itself as the first goal because fundamental logic tells us that without a plan, those responsible for action and accountable for results will not know what to do or what to measure. This is certainly logical, but it is not the entire story. We have all observed that strategic plans never fail in the boardroom; when they do fail, they fail during execution, or all too frequently, because of the lack execution.

This brings us back to the “what else” question. In researching why so many strategic plans fail during execution, we saw that the strategic plan, as a static document, became less relevant and more difficult to execute with age; the older the plan, the greater the degree of failure. In fact, we now believe strategic plans become obsolete the moment they are published. In observing highly successful captives, we saw strategic planners constantly answering, “What else could we be doing?” In other words, we saw that ***the process of strategic planning is more valuable than the plan itself.***

A simple shift of emphasis, away from viewing the creation of a strategic plan as the goal, to continuously engaging in the act of planning while executing the plan, creates a platform for long-term financial viability and the realization of virtually any goal the captive owners set their sights on. This shift in emphasis, in large part, will define or redefine the culture of the organization.

The captive as a strategic asset - continued

A dynamic and proactive strategic dialogue produces results that exceed original captive financial goals because at its heart, a captive is a collaboration that seeks to invest the wisdom, resources and shared purposes of its stakeholders. Constantly striving to make the most of a captive's resources and capabilities makes it possible to constantly articulate clear directions for its purpose and goals. When this is happens, owners can:

- Enjoy increased clarity and confidence about the future;
- Use a simple, relevant dashboard report to monitor actions and progress;
- Enhance internal and external accountability;
- Create a cohesive, proactive advisory team;
- Implement an accountability structure for advisor performance;
- Enhance advisor value and impact;
- Eliminate or mitigate surprises in the board room;
- Ensure compliance and continuously demonstrate the board's fiduciary responsibility to the insurance marketplace, the regulatory domicile and other dependent parties;
- Ensure the board and staff understand all issues the captive is required to address;
- Maximize pay back (e.g.: return/reduction of premiums, risk management grants, etc.);
- Gain optimum return on resources committed to the captive;
- Develop a foundation for financial integrity to assure accountability and transparency;
- Take ownership of a "policy" to govern and direct the management of the captive;
- Create a dynamic, living document to test and measure accountability standards duly established by the board, and;
- Take advantage of new opportunities and address new challenges as they arise.

In summary, employing the plan as a dynamic tool will help you navigate the many forks in the road your captive will encounter over time. This means the value of the captive can exceed the original intent and, in most cases, the original business plan. Once it is achieved, financial viability serves as a platform for the creative application of resources, knowledge, and collaboration. The captive undergoes a transformation of purpose in which the ancillary benefits become the dominant benefits and the once dominant become ancillary. Continuous strategic planning gives key decision makers the power to direct the momentum and assets of their captive towards meeting any challenge they face or opportunity they choose to seize.

Core strategies – a model to build on

Supporting the concept of continuous strategic planning are four core strategies:

1. Job #1: Financial viability without painting the captive into a corner
2. Committed champions
3. Accountability teams
4. Taming elephants

Job #1: Financial viability without painting the captive into a corner

In an ideal situation, the captive is created with a big vision, one that allows for the possibility of additional goals and purposes beyond financial viability and the achievement of related financial goals. It is OK to not be clear about what those future goals will be; it is sufficient to allow for the possibility of moving beyond the purely financial. This has to be discussed and then written into the definitions of why the captive exists.

The good news is, owners and managers can, at any time, retrofit their captive with an expanded vision. To create this outcome, access to sufficient capital is critical. If a captive does not have the financial capacity to operate, whether at start up or when it is ten years old, the plan will be deficient. However, once the captive begins generating ROI, security and independence can be leveraged to address ongoing needs and opportunities.

What really works

In our experience, the best results are achieved when captive owners use their own capital versus borrowing from a third, impartial party. This is why a well designed business plan – one that is beyond the plan required by domicile regulators and follows a logical sequence of identifying challenges, dangers, opportunities and strengths – and the consensus of all stake holders is critical from the very beginning. Without it, potential owners/investors will lack confidence about captive viability and future ROI.

Committed champions

A long-term, and consistent commitment by the governing board and the primary stakeholders is critical to the success of any captive. In an ideal situation, a consensus exists in which the captive is seen as a change agent; a source for amassing wealth and improving the risk financing environment and situation of all participants. As we have stated, when stakeholders invest their own capital, by sheer force of nature, their level of commitment increases. But, in order for the captive to achieve its full potential, the governing board and primary stakeholders must go beyond committing their capital.

Core strategies

Committed champions (continued)

What really works

Even before financing is secured, a commitment to achieving consensus must exist. This means cooperation, compromise, flexibility, open mindedness, collaboration are necessary if the captive is to survive and thrive. Ideally, consensus is based on a shared passion for risk management and safety: the captive board and no one else can drive the monetary incentives to improve claims experience, reduce claims, improve safety and enhance the environment for the captive participants and their organization or organizations. Above all, the board and primary stakeholders must be advocates for the captive's ultimate success.

Additionally, the board and primary stake holders must be prepared to invest their time, not only on the front end during the start up phase, but also on a regular, periodic basis. This investment of time is rewarded when it is spent learning about the business of managing a successful captive. Building on this, a commitment to education for all stakeholders increases stability, efficiency, reduces misuse of captive benefits, and increase the overall satisfaction of all parties.

Accountability teams

Through their ongoing contribution of attention and participation, the board and primary stakeholders demonstrates their commitment to making the captive work. The most successful form of participation occurs when they take on active leadership roles in areas where they possess the appropriate skills, experience, and, most importantly, the desire necessary for success. This enables them to play a pivotal role leading teams of external consultants and internal managers in a focused and accountable fashion.

What really works

In order to earn and maintain the trust and support of all other captive participants, transparency must exist. Therefore, setting clear, measurable goals and benchmarking progress is critical to the success of each accountability team. Taking action, doing what is needed to achieve the goals that have been set, even when it means holding others accountable for their contribution, demonstrates true leadership.

Core strategies

Taming elephants

It is inevitable, at some point during the life of a captive an elephant will walk into the room. The captive board and primary stakeholders have a choice when this occurs. They can ignore the elephant hoping it will go away or they can take it on. Elephants come in many forms including stakeholder issues (e.g. pending bankruptcy), political and economic crises, external advisor performance, personal issues, and many others. Based on all that we have said, it is critical that all elephants be addressed with a sense of urgency before they cause irreparable harm.

What really works

When things change, the board and primary stakeholders managing the most successful captives are quick to recognize the need for a new approach. At these times, ready access to alternatives, the ability to invest in these alternatives, and the confidence that the alternatives will provide the solution is required. When challenged, the most successful captives are able to draw on their collective wisdom, guiding principles, and fundamental strategies to achieve the ultimate goal.

Case studies

The following cases will demonstrate a few examples of factual situations that lead to the need to consider an independent and objective review of past performance and establish clear and consensus-based direction for the future.

Case Study #1: Lost beyond the business plan

Starting condition: The captive's board decided solutions were needed to overcome and manage the following issues and opportunities:

- Gain consensus on how or if we grow the captive outside the expected normal growth from current operations or stay the course
- Establishing rules and criteria for distribution of Surplus
- Establishing roles and responsibilities for oversight of the captive to manage clear and timely communications and operational progression. Decide who was the “quarterback”.
- Gain consensus on opportunities to share resources such as risk management grants
- Establish the parameters to form the basis for the purchase of reinsurance
- Re-commit to the benefit and respect of multiple owners when future, competitive insurance markets challenge the value to each owner
- Gain consensus on a means to value the vendor/consultant “partner” relationships
- Gain consensus on the standards for compliance and best practices
- Establish rules to govern the investment strategy
- Establish rules to govern the underwriting process

Causes: The organizations' leadership concluded that the success and history of their captive was favorable after three years in existence. However a sense of anxiety arose as the board asked, “What should we do next?” There was also an admission among board members that they “Didn't know what they didn't know”. Combined, these led the board to recognize the need to plan for the future versus merely waiting and watching.

Decisions made: Following our defined process for producing consensus and actionable and sound strategies, the Board approved a rigorous plan including eight issues for immediate action from an original list of over 20 issues. The advisors to the captive were involved with the creation of an action work plan within a defined timeline for completion.

Case Study #2: New beginning multiplies value and results

Starting condition: Four independently owned emergency medicine physician practices joined together, and after three years discovered – with the encouragement of their attorney – that the captive appeared to be up and running well on its way to success. The board, though feeling a sense of comfort with this declaration, asked the question, “Well then, now what?” and consensus on their future became a challenge.

Case studies

New beginning multiplies value and results – continued

Causes: The board did not have anyone who was not in a conflict of interest to see them through the following challenges:

- Consensus on if they should grow the captive, and, if so, how it should be done
- Establishing the criteria and other elements associated with adding new shareholders
- Reviewing the capitalization of the company to project the future growth options
- Establishing rules and criteria for distribution of surplus
- How to recognize viable new opportunities for growth
- Determining the best methods and means for sustaining profitability while managing future risk

Decisions made: Once the board accepted that the captive was financially viable, they had to construct a common vision for their stakeholders, build consensus on how to get there, and embolden their advisors to guide and direct the future of the company to meet a set of well-defined goals and strategies.

The board commissioned a rigorous planning retreat and engaged in a well-defined, co-developed process to achieve the creation of the Strategic Plan. Once the process to create the plan was underway and the plan published, the board took ownership in the execution and accountability of the plan.

Some very unexpected actions were born during this process:

- The current committee members were charged with executing on the specific areas of the plan that were commensurate with their responsibility
- Meaningful timelines were agreed upon to sustain the momentum of plan execution
- The board became much more focused on the success of attaining certain goals and strategies vs. their own agendas

The issue of whether to grow the company and the criteria in deciding upon ownership was thoroughly vetted with the decision not to add new members. Their businesses were growing which added premiums – during the strategic planning they discovered that all had similar growth plans and no immediate plans to sell their companies. They therefore determined organic growth would suffice in adding more premium and growing the other financial elements of the captive..

It became apparent there was a need to create a robust risk management and patient safety program before seeking new owners just for the sake of premium and capital contributions.

Case studies

New beginning multiplies value and results – continued

Decisions made: The board realized that distribution of “excess” surplus in the capital account was not prudent. Whereas, everyone started with the initial feeling that they had more money in the company than was necessary. They saw that their “surplus” – an actuary did some scenario planning at different loss levels – would disappear if claims were to go to higher frequency levels.

A significant new strategy was discovered during the planning process that the board did not know how to value and set expectations for their key advisors. This was creating frustrations with the board as well as the advisors. A unique process was developed to evaluate and improve upon the performance of the advisors. Even the advisors grew to appreciate the evaluation process since this enabled their constructive input on how to best utilize and compensate them for their services.

“Without this process, we would continue to be debating the same issues without consensus in the board room”. The board consistently asks the right questions and appreciates the answers, knows now what they did not know, and thinks strategically vs. tactically about the use of resources-both human and capital. “Bringing order to chaos allows us to focus on our day jobs and not worry about the risk financing vehicle that we knew so little about.”

In Conclusion

So what have we learned that we did not already know? The traditional model of strategic planning is often met with apathy and resistance as it tends to degenerate into artfully designed documents that surrender to the day-to-day demands of running the business. However, the creation of a rigorous and dynamic planning process can produce accountable goals, objectives, tactics and assignments for plan fulfillment. Executing on a traditional strategic plan is difficult if not impossible. Embracing the model presented here is a practical way to assure the more broadly defined meaning of viability is achieved.

For more information or to share your experience and views on these issues, contact Barry Couch at HealthSure Consulting Services.

Toll Free: (888) 665-1539

E-mail: barryc@healthsure.com