



# Captive Insurance: An Alternative to the Traditional Insurance Approach

## RIMS Connecticut Valley Chapter

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February 15, 2017

# Agenda

- What is Captive Insurance?  
(Ryan M. Suerth)
- Advantages (and Potential Disadvantages) of Captives
- Some Captive Types
- Risks Insured
- A Captive's Home
- Captives in Connecticut
- Captive Types in Connecticut
- A Connecticut Captive Example
- Establishing a Captive
- "How to Determine if a Captive is a Good Idea"  
(Stephen R. DiCenso)
- Captive-Related Disputes  
(Melissa A. Federico)

# What is Captive Insurance?

- An alternative to traditional insurance (i.e., purchasing an insurance policy for an organization from a commercial insurance company)
- Captive insurance, more formally known as a “captive insurance company,” or less formally as a “captive,” is an insurance company created to insure risk for the captive’s owner(s) and/or related entities.
- In Connecticut, a captive insurer is described as “an insurance company owned by another organization whose exclusive purpose is to insure risks of the parent organization and affiliated companies or, in the case of groups and associations, an insurance organization owned by the insureds whose exclusive purpose is to insure risks of member organizations and group members and their affiliates.” See C.G.S.A. § 38a-91

# Advantages (and Potential Disadvantages) of Captives

- Some Advantages
  - Ability to reduce cost of insurance
  - Ability to write broader coverage or coverage for risk an organization cannot insure through a commercial insurer
  - Ability to reinsure
  - Ability to control claims handling
  - Greater emphasis on loss prevention procedures
  - Potential tax benefits and ability to invest

# Advantages (and Potential Disadvantages) of Captives

- Some Potential Disadvantages
  - Start-up costs
  - Capitalization
  - Running an insurance company



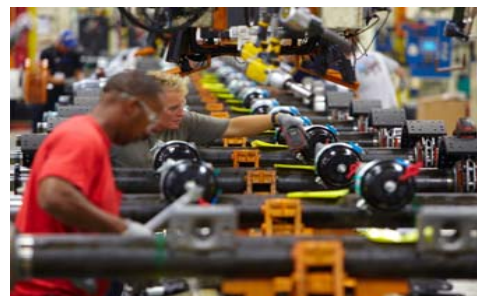
# Some Captive Types

- “Pure” Captive: Created by a single parent organization to provide insurance for the parent and/or its related entities
- “Group” or “Association” Captive: Created by a group of organizations to provide insurance for the group or group members

# Risks Insured



- General Liability (e.g., for construction, manufacturing)
- Auto Liability
- Workers' Compensation
- Property
- Professional Liability (e.g., medical malpractice)
- Other risks as to which commercial insurance is difficult or impossible to procure



# A Captive's Home



- Like any organization, a captive needs a home (domicile)
- Popular domiciles for captives have been offshore (e.g., Bermuda), but various states have created the ability for captives to be established (e.g., Vermont, and yes, Connecticut!)



# A Captive's Home

- Some considerations when choosing a domicile:
  - Regulatory environment
  - Ease of start-up
  - Fees
  - Restrictions on investment
  - Taxes
  - Availability of necessary services
  - Geography

# Captives in Connecticut



- Connecticut is known for insurance, and the State has sought to build upon its reputation, as well as upon its sophistication and knowledge regarding insurance, to attract captives to Connecticut since 2008 with the enactment of P.A. No. 08-127, An Act Concerning Captive Insurance (see C.G.S.A. § 38a-91aa to 38a-91tt)
- The Connecticut Insurance Department established a Captive Insurance Division in 2012, which licenses, regulates and examines captives

See <http://www.ct.gov/cid>

# Captives in Connecticut

- Connecticut also has the Connecticut Captive Insurance Association, a nonprofit trade association established to, among other things, promote the captive insurance industry in Connecticut

See <http://www.conncaptives.org>

# Captives in Connecticut

- In 2012, the State announced its first two captives:
  - Subsidiary of Thomson Reuters, relocated from Delaware
  - Subsidiary of Stanley Black & Decker, relocated from Vermont
- In 2016, the State announced its 10<sup>th</sup> captive in Connecticut (for a construction firm)

# Captive Types in Connecticut

- Captive insurance company means any (A) ***pure captive insurance company, association captive insurance company, industrial insured captive insurance company***, risk retention group, ***sponsored captive insurance company*** or special purpose financial captive insurance company that is domiciled in this state and formed or licensed under the provisions of sections 38a-91aa to 38a-91tt, inclusive, or (B) branch captive insurance company.

See C.G.S.A. § 38a-91aa (definitions)

# Captive Types in Connecticut

- ***Pure captive insurance company*** means any company that insures risks of its parent and affiliated companies or controlled unaffiliated business (e.g., Ryan M. Suerth, Inc. creates RMS Ins. Co. of CT).
- ***Association captive insurance company*** means any company that insures risks of the member organizations of an association, and includes a company that also insures risks of such member organizations' affiliated companies or of the association.
- ***Industrial insured captive insurance company*** means any company that insures risks of the industrial insureds that comprise an industrial insured group, and includes a company that also insures risks of such industrial insureds' affiliated companies.

# Captive Types in Connecticut

- ***Sponsored captive insurance company*** means a captive insurance company: (A) In which the minimum required unimpaired paid-in capital and surplus are provided by one or more sponsors; (B) That insures risks of its participants only through separate participant contracts; and (C) That funds its liability to each participant through one or more protected cells and segregates the assets of each protected cell from the assets of other protected cells and from the assets of the sponsored captive insurance company's general account.

# A Connecticut Captive Example

- CT PRIME, Inc. – A sponsored captive formed for the purpose of assisting Connecticut municipalities and school districts that self-insure employee health benefits with cost savings in connection with medical stop loss insurance.
- CT PRIME was sponsored by the Capital Region Education Council (“CREC”), a Regional Educational Service Center that encourages improved quality and cost-effectiveness through cooperation between municipalities and school districts.





# A Connecticut Captive Example

- Municipalities and school districts that self-insure employee health benefits purchase medical stop loss (or excess) insurance to transfer the risk of large claims to a commercial stop loss insurer.
- CT PRIME was intended to provide stop loss insurance to approximately 15 initial municipalities/school districts in Connecticut, and to obtain reinsurance for claims over a certain dollar amount.

# Establishing a Captive in Connecticut:

## Summary Of Process

### Step 1

- Initial Consideration as to Whether a Captive is Feasible Option (feasibility study)

### Step 2

- Identify Service Providers—Captive Manager, Legal, Claims Administrator, CPA, Actuarial Firm, Reinsurance Broker, Investment Advisor

### Step 3

- Meet with the Captive Insurance Division (include Captive Manager)

### Step 4

- Choose Name and Business Entity Type (e.g., Stock Corporation or Limited Liability Company)

### Step 5

- Draft Documents to Create Business Entity/Organizational Documents (e.g., articles of incorporation, bylaws)

# Establishing a Captive in Connecticut:

## Summary Of Process

### Step 6

- Submit Application with Required Information and Documents
  - Captive Name
  - Captive Type
  - Business Entity Type
  - Director and Officer Information
  - Services Providers
  - Cover Letter
  - Organizational Documents
  - A Business Plan (including, among other things, information concerning the rationale for the captive, lines of coverage, expected premiums, claim management, reinsurance, loss prevention, investments, governance, loss experience)
  - \$800 fee with application (if licensed, \$375/year for initial fee, and at each annual renewal)
  - Process/information required can differ depending on captive type, and if re-domestication involved

# Establishing a Captive in Connecticut:

## Summary Of Process

### Step 7

- Create the Business Entity by Filing Required Organizational Documents

### Step 8

- If Approved, Establish Bank Accounts in Connecticut, and Capitalize the Captive

See C.G.S.A. § 38a-91bb, and <http://www.ct.gov/cid>



# Captive-Related Disputes

Potential Issues, Case Study and Lessons Learned

# Disputes: Primarily Closed Universe

- Most traditional insurance coverage disputes arise in the context of:
  - Breach of contract
  - Late notice
  - Unfair claim settlement practices



# Disputes: Primarily Closed Universe

- 38a-816(6): The biggies

Committing or performing with such frequency as to indicate a general business practice any of the following:

- a) Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;
- b) failing to acknowledge and act with reasonable promptness upon communications with respect to claims arising under insurance policies;
- c) failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
- d) refusing to pay claims without conducting a reasonable investigation based upon all available information;
- e) failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
- f) not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear; and
- g) compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds.

# Parties to Disputes

- Disputes between captive insurance companies and reinsurance companies.
- Disputes between group captive members.
- Disputes between captive owners and outside advisors, such as financial advisors.
- IRS challenges.



# Disputes: Primarily Closed Universe

- Captives typically reinsure risk to reinsurers.
- Mandatory Arbitration Provision.
- Effect: Very few reported cases analyzing claims made by or against captives.



# Disputes: Primarily Closed Universe

- Practical Effect of Arbitration Provision:
  - Lack of uniformity
  - Less control over choice of law
- Policyholder consideration: pool of available arbitrators are typically pro-insurer due to industry experience requirement.
  - See *Scandinavian Reins. Co. v. St. Paul Fire & Marine Ins. Co.*, 668 F.3d 60 (2d Cir. 2012) (arbitrator's involvement in a related case in and of itself did not indicate that they would be predisposed to favor 1 party over another; nondisclosure irrelevant).

# Dispute Focus: Captives and Reinsurers

- **Downside to sitting at the grown-ups table:**
  - Reinsurance contracts are negotiated at arm's length by sophisticated parties.
  - The canons of contract construction that protect individual purchasers of insurance **do not apply** to reinsurance.
    - Unigard Sec. Ins. Co. v. North River Ins. Co., 4 F.3d 1049 (2d Cir 1993)



# Dispute Focus: Captives and Reinsurers

- **Notice**
  - prompt notice of:
    - “claim” or
    - “incident that may result in the filing of a claim”
- Failure to comply with notice provision may provide reinsurer with defense to indemnification under the reinsurance contract.
- Law varies from state to state.
- Notice from insured to ceding insurer is not notice to the reinsurer.

# Dispute Focus: Captives and Reinsurers

- **Notice, cont'd**
  - Courts are divided as to whether timely notice is a condition precedent to coverage, or whether some element of prejudice to the reinsurer must be shown.
    - 2<sup>nd</sup> Circuit: Christiana Gen. Ins. Corp. v. Great Am. Ins. Co., 979 F.3d 268 (2d. Cir. 1992): reinsurer must show that prejudice resulted from the delay in the absence of an express provision in the contract making prompt notice a condition precedent.

# Dispute Focus: Captives and Reinsurers

- The duty of “Utmost Good Faith”
  - Requires the ceding insurer (captive) to disclose to the reinsurer all material facts about the risk being reinsured.
- Duty is affirmative: reinsurer has no duty of inquiry.
- Extends to:
  - Underwriting and administration.
  - Duty to give notice.

# Dispute focus: Captives and Reinsurers

- Follow the settlement: requires the reinsurer to accept the good faith claims determinations made on losses coming within the underlying policy and the reinsurance contract.
- Follow the fortunes: requires the reinsurer to follow the underwriting fortunes of the ceding insurer.

# Dispute focus: Captives and Reinsurers

- Additional Clauses of Import:
  - Access to records clause: inspection/audit (generally excludes attorney work product/attorney-client privilege).
  - Associating in the defense: cooperation clause.





# Case Study: Philadelphia arbitration

- Single entity captive for a hospital involved in dispute with reinsurer.



# Case Study

- 2008-2009 policy year: SIR and claims made policy with Co. A as excess carrier.
- 2009-2010 policy year: claims made policy with Co. A as reinsurer:
  - primary coverage: captive- \$3 million
  - Excess coverage: captive- \$30 million
    - \$30 million excess reinsured
      - \$10 million: Co. A
      - \$10 million: Co. B
      - \$10 million: Co. C

# Case Study

- Relevant policy provisions:
  - TPA Notice Requirement: Potential Claim category: “a circumstance or happening involving injuries or alleged injuries likely to give rise to claims or suits a/k/a a potentially compensable event (“PCE”) or an incident.”
  - Captive Notice Requirement: reasonably likely to result in a claim involving (a) reserve of more than \$500,000 or demand exceeding \$3 million limit. Notice of an incident reported “as part of loss control services” is not notice of a claim.
  - Co. A Notice Requirement: as a condition precedent, captive shall immediately advise of incident (a) evaluated as having settlement value of \$3 million or more; (b) reserved at \$1 million or more; (c) any claim involving unanticipated death or brain injury; or (d) circumstances involving injuries reasonably likely to give rise to claims.

# Case Study

- Facts:

- Medical incident occurred during 2008-2009 period.
- Captive argued claim was “made” in 2009-2010 policy year, when attorney requested medical records.
- Notice was provided within days of the claim being made by Plaintiff’s attorney **BUT**:
  - Hospital had reported to TPA in 2008-2009 policy period.
  - TPA completed Co. A’s Notice form with:
    - Wrong forms: 2008-2009 policy period
    - Wrong policy numbers: 2008-2009 #s
    - Wrong date claim was first recognized: listed DOL instead



# Case Study

- Facts, cont'd
  - Reinsurer received regular updates from captive adjustor and defense counsel for approximately 2 yrs.
  - 2 years after claim opened (and immediately following receipt of \$15 million demand by plaintiff's counsel) Co. A issued denials for 2008-2009 policy period.
  - Captive responds that the claim is being handled under the 2009-2010 policy period, and demand implicates excess layer and reinsurer's obligation.
  - Reinsurer reserves rights, arguing claim falls under 2008-2009 policy period, and notice was late.

# Case Study



- Facts, cont'd
  - (Although not obligated) ceding insurer requested that reinsurer attend and participate in mediation.
  - Defense experts already opined that conservative estimates exceed the primary layer and will implicate the reinsurance obligations.
  - Captive handcuffed in settlement negotiations with plaintiff.

# Case Study

- Mandatory Arbitration:
  - Issues
    - Timing in relation to trial
    - Ripeness
    - Follow the fortune



# Takeaways

- Take care to maintain separate corporate identities, including professional insurance management for the captive.
- Capitalize the captive adequately to provide appropriate reserves without periodic support from the parent.
- Have independent insurance managers handle claims.
- Use policy forms that are comparable to those in the market.
- Make sure everyone in the risk management chain is aware of notice procedures; identify inconsistencies.
- Obtain reinsurance contracts from established reinsurers.



# Conclusion

Questions or Comments?

Share an experience with captives?



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