Directors’ responsibilities

What are the basics of what’s expected of a captive’s directors? Tom Jones noted that they are supposed to show due skill, care, and diligence in overseeing the operations of the captive, and in addition, play an oversight role in adequately supervising the captive’s service providers. This means that they should attend all of the board meetings and read all of the meeting materials, including the board book, before they go—so they can ask the difficult questions. They don’t have to understand the actuary’s Bornheutter-Ferguson formula, or how many Monte Carlo simulations were done. They do need to talk to the actuary, and test all of the assumptions he used (in regard to items like investment returns and discount rate), ask good questions, and hopefully get good answers.

So that is the standard. Board members don’t need to know everything, but they do need to know how to oversee and discharge their responsibility for stewardship over the assets of the captive.

Fiduciary duties

The concept of fiduciary duties applies to both group and single-parent captives. The directors have to act in the best interest of the captive, and disclose any conflicts. But what does that really mean? What if a director of a captive is also senior officer of the parent? Then, how does the meeting go?

When the directors are actually voting on a resolution, the directors at the captive meeting have to have the best interest of the captive at heart. This means, essentially, the balance sheet of the captive—the assets and liabilities that appear on that piece of paper.

Sometimes directors will say, “but I’m also affiliated with the parent, so I have to worry about the parent’s interests. That’s true. But it does conflict: you have to be thinking of the captive’s well-being.”

If the captive is in financial trouble and the directors are all senior managers of the parent, then the question is, are the directors required by law or some other duty, to try and force the parent to put in more money? The answer that the regulators expect is that yes, indeed, they would put in more money. But in fact the captive directors have no duty to try and force the parent to infuse more funds. They have a duty, instead, to diligently deal with the money that is in the captive.

With greater scrutiny of captives including the adoption of the NAIC corporate governance standards for risk retention groups, many captives are re-examining their corporate governance practices. In a recent presentation sponsored by Strategic Risk Services, the need for a corporate governance framework was explained, and some best practices for governance standards were related.

The speakers were, first, Tom Jones, Partner, McDermott Will & Emery LLP. Mr. Jones focused on federal and state tax, insurance, regulatory, and legal matters concerning captives. He offered a general overview of governance in captives. Then, Tim Padovese, President and CEO, Ophthalmic Mutual Insurance Company (OMIC), a risk retention group (RRG) insuring more than 4,800 ophthalmologists nationwide, filled in the general outlines with specifics as they apply to the operations of OMIC.
So sometimes when these conflicts come up, it’s possible to do something like the following. I bought some red and blue baseball caps. And every time someone spoke at the board meeting, they’d put on one cap or another, to indicate whether they were speaking in behalf of the parent or the captive.

Board members are very interested in how they get indemnified, and our by-laws (or “articles of association,” depending on where you live) include indemnification provisions, to the maximum extent permitted by law, but generally excluding dishonesty, willful default, gross negligence, etc., of a director. Most captives have some kind of D&O policy that protects the captive board included as “additional insureds” if it is a single parent captive. If it is a group captive, they will need to purchase this coverage.

Who should be on the board?
Perhaps the best way to consider composition of the board is in terms of functionality: you want the various types of expertise that are needed all to be represented on the board. The goal is to have a well-rounded board in which each member adds incremental benefit to the full board. If it’s a hospital, you probably want the chief medical officer, and for the bigger hospital systems, there may be the head of nursing on the board, since that’s where the rubber meets the road in terms of where claims emanate from. You want the expertise, someone who can talk about what’s being done to prevent future claims and how you mitigate existing claims.

- Some legal input, general counsel or associate counsel
- Claims person; the risk management function is crucial in the whole situation
- There may or may not be an independent director.

The goal is to have a well-rounded board in which each member adds incremental benefit to the full board. If it’s a hospital, you probably want the chief medical officer, and for the bigger hospital systems, there may be the head of nursing on the board, since that’s where the rubber meets the road in terms of where claims emanate from. You want the expertise, someone who can talk about what’s being done to prevent future claims and how you mitigate existing claims.

How often should they meet?
Certainly, the boards of the bigger captives meet quarterly; those of the offshore captives meet less frequently, perhaps once or twice a year, given the high cost of travel. The meetings should be captured in carefully detailed minutes, about every aspect of running the captive, so people recall what was said. Also, in the event of an IRS audit of the captive, the minutes document can demonstrate that the captive really is a serious insurance company.

You don’t want so-called dead wood on the board, but keep in mind that it usually takes three to five years to learn how to be a good director. So it’s really a shame to force someone off the board, just at the point when he’s mastered what it takes to be an effective director.

Board governance: OMIC
The Risk Retention Act that was passed in 1986 specified that the insureds in an RRG should practice in the same professions, carry out similar activities, or have the same exposures. In response, and also in consideration of the crisis in availability of MPL insurance, OMIC was formed, in 1987. The original insurance program was established by the American Academy of Ophthalmology (AAO). The initial capital contribution from AAO, $1 million, was repaid within nine months. New insureds were required to
pay twice the annual premium, for the
first year only, to provide the capital, with
half paid to equity; surplus notes were
issued.

Overall, the initial challenges OMIC con-
fronted pertained to the feasibility study,
capital, the board, the managing general
agency, and the transition to a
standalone company within the span of
roughly three years.

Now, OMIC is a fairly complex company,
which writes in all 50 states. In 2016,
premiums totaled $41.1 million, and sur-
plus growth was $208.8 million. There
were 4,880 policyholders, and the com-
pany had a 45% market share.

There are presently 15 board members
and eight committee members; the board
members come up through their assign-
ments on the committees. Board
meetings are held three times each year.
The entity is rated “A” by A.M. Best.

Financial reporting
OMIC established a Corporate Compli-
ance Officer to oversee the reporting
process. At OMIC, this person is also the
in-house counsel. The report, now 13
pages long, is distributed to the board
and discussed extensively by the Audit
Committee. The financial report includes
statements and copies of the tax forms
filed with federal and state governments.

Also included are forms pertaining to
compliance with the regulations for an
insurance company. These include infor-
mation such as a regulatory overview,
capital requirements, approval of service
providers (done every year, through the
Audit Committee), and disclosure of any
conflicts of interest.

The goal is to have a well-rounded board in which each
member adds incremental benefit to the full board. You want
the expertise, someone who can talk about what’s being
done to prevent future claims and how you mitigate existing
claims.

There are statements on regulatory re-
quirements such as HIPAA and the Center
for Medicare & Medicaid Services. They
also check to make certain that any entity
dey do business with is also in compli-
ance.

There are also governance standards for
appointment of officers, board and com-
mittee training, election of officers and
terms, actuarial review, and an independ-
ent audit.

Human Resources of OMIC also ensures
that the organization is in compliance
with all applicable strictures, like those
for COBRA.

Term limits: OMIC
Fifteen years ago, there were no term
limits for the OMIC board. But that be-
came problematic at one point. And
there were no formal processes for filling
the committees. So OMIC inaugurated six
one-year terms on the committees; after
that, the committee member is sent up
to the board for three three-year terms.
The majority of the board is made up of
ophthalmologists.

OMIC has been fortunate enough to have
doctors who are also knowledgeable in
other areas, in finance, for example (they
may hold MBA degrees). To identify
these individuals, OMIC sends out letters
to all of its 4,800 policyholders, asking for
names of people with skills like financing
as well as individuals who have specific
subspecialties.

When the names come in, they are re-
viewed by a selection committee, a nomi-
nating committee, and the executive com-
mittee, to make the choices that will fill
the committee positions that will serve to
make the company whole. ỀPIAA