DOs & DON'Ts FOR YOUR CAPTIVE

David Liptz, Eric Weber and Kenneth McAlpine of HKG showcase an essential list of what to do and what to avoid when it comes to your captive

Written by
David Liptz

David Liptz has over 25 years' experience working with captive insurance companies. Liptz regularly speaks, consults and discusses captive insurance tax and audit issues with captive owners and others that work within the captive insurance industry.

Written by
Eric Weber

Eric Weber has over 25 years' experience working in public accounting, the last six of which have been in the captive insurance industry. He has also obtained his ACI designation from the International Centre for Captive Insurance Education.

Written by
Kenneth McAlpine

Kenneth McAlpine is an audit manager with HKG, LLP and has over 30 years' auditing experience at both national and local US accounting firms. He is certified in financial forensics by the AICPA and has served as a peer reviewer for the AICPA.

Through previous audits we have been able to identify some of the most common deficiencies and inefficiencies that can affect the fees of running your captive. With this knowledge, we have compiled a must-read list of dos and don'ts that can help your captive avoid costly mistakes.

At HKG, we find that communication is the key to success. It is important that your captive manager, CFO, CEO, attorney, CPA and other team members are all on the same page. Many of our clients routinely communicate with us which allows us to coordinate the client's vision with their team of professional advisors.

Many captives are not treated with the same degree of importance as their affiliated entities. Insurance companies are sophisticated, complex, and regulated entities that demand appropriate levels of attention and should not be treated merely as side businesses.

As companies move through their life, their surplus normally grows. We find the intricacy of transactions from alternative investments to reinsurance assumptions to loss portfolio transfers to expanding lines of coverages, etc, increases. This requires more timely communication and formalised documentation.

Proper governance of your captive operations is very important from internal, regulatory, and tax perspectives. While large insurance companies have had many years to develop highly formalised procedures and documents, many enterprise captives have not. Yet, the Departments of Insurance (DoI) and taxing authorities still require the same degree of formality in operations and records. Often, the audit process reveals a lack of properly executed insurance agreements; a lack of suitable support for alternative investments; a lack of proper governing documents, such as minutes; and inconsistencies between the DoI-approved business plan and company activities. How can the captive achieve a high level of operational maturity quickly?

The answer is through the use of a qualified insurance manager and other professionals that will provide the captive with top quality guidance and documentation. Of course, it does no good if the captive owner doesn't follow the advice of such professionals. This list is not all-inclusive.

DOS AND DON'TS

Do:

1) Maintain notes receivable in a formalised manner and up to date
2) Maintain current and signed insurance policies and reinsurance contracts
3) Obtain DoI approval for all insurance coverage changes prior to implementation
4) Consult with your tax advisor, auditor, and insurance manager for all investment strategies to ensure that they will adhere to the business plan and meet your goals
5) Be engaged and knowledgeable in all aspects of the captive business (e.g. business rationale for the captive formation, coverages being issued, and how they fill in the gaps from their commercial coverages) and be as engaged as you are with your operating companies.

Don't:

1) Engage in excessive related party investments, including loan-backs. It is particularly important that related party activities be scrutinised for financial soundness and documented with formality
2) Wait until after the fact to inform your insurance manager about changes in your ownership structure
3) Procrastinate in getting your books closed
4) Minimise the importance of your understanding the story that your financial statements are telling
5) Fail to hold annual meetings and execute all minutes and resolutions.