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Sanitising the plan

With unforeseen claims and costs, the industry is seeing a rise in businesses considering a medical stop-loss captive

Malta Focus

As uncertainties surrounding COVID-19 play out, Malta looks at how it can adapt to remain competitive

Emerging Talent

Ryan Peruski
Partner
Honigman

Independent Directors

Now more than ever independent directors are important to captive insurance company governance

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In this issue

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SunTrust

Christopher Jarvis wins court battle against Arsenal Insurance over Jade Risk

A judge at the US District Court for the Middle District of Alabama has ruled in favour of Christopher Jarvis, former owner of Jade Risk, after he filed a lawsuit against Arsenal Insurance, a subsidiary of TaylorChandler, for breach of contract.

TaylorChandler agreed on a deal with Jarvis to purchase Jade Risk for $3 million at the end of 2015. As part of the agreement, Jarvis signed a 60-month employment agreement with TaylorChandler to remain at the firm.

However, in 2017, Jarvis' employment was terminated by employees of TaylorChandler Britt Taylor, Norman Chandler, and Johnny Johnson for his "pre-deal conduct".

Judge Andrew Brasher ruled that "TaylorChandler breached the employment agreement".

Brasher explained: "The employment agreement provides that, in the event of litigation, the loser will pay the winner's 'costs and expenses (including attorney's fees).'

Accordingly, Jarvis is due to receive deferred salary, bonuses, and his expenses and attorneys' fees for litigating this action."

In his conclusion, the judge said: "Jarvis substantially performed the contracts he signed with defendants, and they were never excused from their payment obligations under the employment agreement and promissory note."

The sale of Jade Risk

Jarvis sold captive manager Jade Risk to Taylor, Chandler, and Johnson of TaylorChandler in 2015 due to the increasing running price of the business.

By the end of 2015, the parties had agreed to a purchase price of $3 million for Jade Risk and sought to close the deal.

TaylorChandler applied to borrow money from Synovus Bank to complete the purchase. Part of the money for the loan came from the Small Business Administration and with it came an important limitation: if a loan from the SBA is used to buy a business, the seller may not remain employed with that business for longer than a year after the purchase. Jarvis, Taylor, Chandler and Johnson developed a workaround where Jarvis became an employee of TaylorChandler itself to satisfy the bank, according to the judge.

In 2016, Jarvis informed Chandler that Jade Risk had 35 active captives, however, 12 of those captive clients surrendered or dissolved bringing the number down to 23. The deal closed four weeks later without a change in terms of the purchase price. The judge explained that Jarvis made financial concessions to assuage TaylorChandler's concerns that surrendering captives and increased regulatory scrutiny would translate into a loss on the deal.

Jarvis volunteered to defer $175,000 of his salary and $750,000 of the purchase price and suggested that the agreement include performance benchmarks that could substantially reduce the deferred payments if he failed to meet them.

Problems emerged

After the deal closed, it became difficult to merge Jade Risk into Arsenal and convert Jarvis from an owner into an employee. Brasher noted two reasons for this: federal regulatory challenges hurt the captive insurance industry and fundamental differences in philosophy strained the parties' relationship. The federal regulatory changes that were causing problems was the Internal Revenue Service's (IRS) Notice 2016-66, which formally labelled micro-captive transactions as "transactions of interest". Chandler testified at trial stating that the notice had a "chilling effect" on the captive industry.

In the court case, the judge suggested that Jade Risk was "aggressive" in selling micro captives for tax purposes. The judge referenced a PowerPoint webinar that Jarvis had used which mentioned Arsenal as the owner of a hypothetical case study to illustrate how a construction company could dramatically reduce its tax liability by using a captive.

The judge said: "Chandler testified at trial that, because it framed captives as a tax dodge and would draw the ire of the IRS, he had told Jarvis that he didn't want Arsenal's name on it. Jarvis denies being told this."

However, the court found that "Chandler never told Jarvis not to use the case study, although he clearly did not want Jarvis to use it".

In his opinion, judge Brasher stated that the "deal was doomed before the ink was dry. It fell apart less than a year after closing."

Among the issues that had already occurred, electronic files were reported missing and Jarvis had also allegedly retained an Apple laptop which became the property of Arsenal Insurance as part of the acquisition. In terms of the missing files, Julia Stuart, a longtime administrator for various financial institutions and former Jarvis employee, testified that although she preserved emails for Jarvis' defence and wiped data from the desktop computer, Jarvis did not order her to do so.

In her initial deposition, Stuart said she didn't delete anything from the computer, but in a subsequent affidavit, she admitted to "deleting everything as well as shredding all the hard documents that were on site".

At trial, Jarvis testified that he did not know the destruction of documents because he was overseas when it occurred. But before trial, Jarvis wrote in an affidavit that he authorised the shredding "because he did not want the documents to be discovered by other office tenants".

The court found that this evidence was destroyed in bad faith.

The judge concluded that although there was "a lot of testimony during the trial about the captive management industry and best practices in creating and maintaining such insurance companies.

The court appreciated that testimony — it was very interesting — but it was not especially relevant".

He explained: "This case is ultimately about written agreements that memorialised an arms-length deal between sophisticated parties.

The court concludes that Jarvis substantially performed the contracts he signed with defendants, and they were never excused from their payment obligations under the employment agreement and promissory note."

The judge noted that there are three issues that remain to be resolved, which include the defendant's spoliation sanctions, Jarvis's costs and attorneys' fees, and prejudgment interest.

He said: "After these issues are addressed, the court will enter a final judgment as a separate document that (1) awards Jarvis $175,000 in deferred salary from TaylorChandler, $160,000 in captive origination bonus payments from TaylorChandler, $512,286.88 in promissory note payments from individual defendants Taylor, Chandler, and Johnson, and appropriate prejudgment interest; (2) requires Jarvis to render unto TaylorChandler the MacBook Pro laptop or its value in 2017; (3) awards spoliation sanctions to all defendants in the amount of attorneys' fees and expenses expended to develop and litigate the spoliation issue; and (4) awards Jarvis his attorneys' fees and expenses in litigating this action." ■

Oklahoma to reduce capital requirements for certain special purpose captives

Oklahoma's insurance commissioner Glen Mulready has issued a notice to advise all participants in the captive insurance industry on the reduction of required capital for certain special purpose captive insurance companies. The Oklahoma insurance department (OID) pursuant to 36 O.S. § 6470.20 and 6470.34 determined that as of the 16 September 2020, the capital requirement for certain special purpose captive insurers will be reduced from $250,000 to $50,000.

The reduction in minimum capital and surplus is available only to special purpose captive insurers organised as a 'series' pursuant to 18 O.S. § 2054.4 and does not accept or receive direct or assumed risk; does not issue any form of an insurance contract; insures the risks of its participants only through separate participant contracts.

Additionally, special purpose captive insurers will need to fund liability to each participant through one or more protected cells and segregate the assets and liabilities of each protected cell from the assets and liabilities of other protected cells and from the assets of the special purpose vehicle insurance company's general account.

Jerry Messick, CEO of Elevate Risk Solutions, said: "For instance, it will allow a broker to sponsor a series captive structure without having to commit a large statutory capital amount.

As the sponsor allows no liability at its level, it naturally forces each series captive to provide its own adequate level of risk capital to operate."

"The fact the commissioner and his team researched this and was quickly responsive to an industry need is yet another reason Oklahoma is focused on developing its captive regulatory platform," Messick added.

Commissioner Mulready noted that written application for this reduction is required and needs to be directed to the captive division.

He added that if this reduction allowance is approved, the reduction will be documented by a company-specific order.

Additionally, in May, Oklahoma's governor Kevin Sitt has signed HB 3864 into law, which sets out how premium taxes by captive insurers should be distributed within the state of Oklahoma. ■

ACIA reveals safety protocols for in-person event

The Alabama Captive Insurance Association (ACIA) has released official safety protocols for its annual conference, which will take place as the first in-person captive event since the COVID-19 pandemic.

The conference, taking place in Birmingham, Alabama at The Westin Hotel & Resort on 16 to 18 September 2020, will have several safety measures to ensure a safe conference for attendees.

These include providing masks with filters to all attendees each day of the conference and setting up all meeting spaces with social distancing guidelines.

ACIA will also provide hand sanitiser to all attendees with additional sanitiser stations set up throughout the venue.

It will utilise hotel staff for contact-free distribution of all food and beverages, including buffets, while also implementing a 'no-touch' conference greeting.

Norman Chandler, president of ACIA, said: "We understand the concern surrounding the COVID-19 pandemic and are collaborating with our event venue to successfully ensure a safe environment during the 2020 conference following COVID-19 safety guidelines recommended by the Centers for Disease Control and Prevention." ■

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McGriff launches new group captive solution

McGriff has formed a new group captive practice, McGriff Captive Solutions.

The new practice will serve as an advisory resource for companies seeking a more cost-efficient way to finance risk while offering members ownership of their underwriting profit otherwise retained by an insurance company.

Leading the new practice will be Steve Aldrich, a 40-year industry veteran. Additionally, he will serve as McGriff's industry practice group leader.

Aldrich, who joined McGriff in 2001, will manage global captive programme formation for the middle market, ensure programmes comply and follow best practices, and work with clients and broking partners to develop new captive products and resources.

According to McGriff, the new group captive solution is the next step in the alternative risk transfer operations of McGriff and parent company Truist Bank.

MBT, a Bermuda-based single-parent captive and reinsurance company founded in 2001, is owned by Truist Financial Corporation and also managed by McGriff.

Rick Ulmer, McGriff CEO, highlighted: "Captives are a critical risk mitigation strategy for our clients."

Ulmer added: "Steve Aldrich was instrumental in the original formation of the Truist captive and is the right person to develop a strong captive strategy for our firm. He understands the business and is uniquely positioned with our McGriff industry practices and Truist Bank verticals to help drive the strategy, structure, and engagement between our various stakeholders."

Commenting on his appointment, Aldrich said: "Given the hard market we're now experiencing, clients with strong balance sheets are looking for options to control their destiny, rather than exposing their business to the up and down cycles of the insurance industry."

He continued: "I'm excited about building on our success and solid reputation in the captive and alternative risk transfer space with a new entity designed to position us very well for the future."

In May, McGriff Insurance Services and McGriff, Seibels & Williams, the retail insurance subsidiaries of BB&T Insurance Holdings rebranded as McGriff. ■

CICA continues financial support to ICCIE

The Captive Insurance Companies Association's (CICA) president Dan Towle has presented the association's annual $10,000 contribution to the International Center for Captive Insurance Education (ICCIE) during ICCIE's virtual 'sweet 16' anniversary celebration.

The association said it is their 11th consecutive year of the $10,000 contribution.

Towle highlighted CICA's strong support for ICCIE's educational programmes and encouraged others to support the captive industry by contributing to our partners at ICCIE.

"Donations to ICCIE help them to keep their good work moving forward so they can continue to offer classes and evolve their designations to meet industry needs," Towle said.

Recently, Benjamin Whitehouse, attorney at Butler Snow, was named as serving as president of the governing board of the ICCIE for 2020 to 2021. ■

Reinsurance Solutions Group launches new subsidiary

Reinsurance Solutions Group, an independent African-owned reinsurance broking group, has launched a new subsidiary Reinsurance Solutions Intermediary Services (RSIS) in South Africa. The new company will comprise a team of brokers that draw on their global experience as well as skill sets in the local market.

The group offers captive solutions services, underwriting and policy pricing reviews, treaty review and placements. As part of the launch, Cameron Cupido will take on the role of CEO of Reinsurance Solutions Intermediary Services.

Cupido has over 20 years' experience in insurance/reinsurance and brings a combination of product and customer knowledge to his new role.

He forms part of RSIS' newly-appointed executive team, following the granting of its financial services licence by the Financial Sector Conduct Authority in June 2020.

Commenting on the new office, Cupido said: "Its entry into the market is a strategic one, coming at a critical time for the local industry."

He noted: "With the effects of world events starting to be felt in South Africa, and with our reinsurance industry being quite limited, there was an excellent opportunity for us to bring to market a new player with new offerings."

"We are a niche and highly focused team, which allows us to quickly adapt to changing conditions and develop responsive reinsurance solutions as and when our clients need them."

"This undoubtedly gives us a competitive edge," he added. ■

2020 conditions have created 'innovative interest' in captives

The "perfect storm" of insurance market conditions during the spring and summer of 2020 has generated growing interest in alternative insurance, according to panellists at the Vermont Captive Insurance Association's (VCIA) virtual conference.

Speaking at the 'Innovation and emerging risk spotlight: captives in 2050' panel, Peter Foley, senior managing director at Arsenal Insurance Management, identified that 2020 has presented unpredictable challenges, with the COVID-19 pandemic exposing underlying long-term issues, as well as a gradual but accelerating transformation towards the gig-economy and insurtech investment.

Foley added the pandemic and current work from home model has raised the important question of insurance coverage, as gaps in protection have led to an interest in alternative insurance, namely captives. However, he also noted that "2020 has the potential to be a pivotal year for captives if managed properly".

Edward Koral, managing director of BDO USA, noted that the work from home model has impacted the gig/sharing economy. As personal and work coverages have seen an increasing overlap – for example, personal property as a multi-purpose workplace – the insurance industry as a whole has seen a reassignment of where insurance risk belongs and who is responsible for it.

These questions surrounding what now constitutes occupational health and safety, as well as concerns of the privacy and security of online meeting platforms and personal data, and the status of what constitutes an 'essential worker' and their related healthcare insurance, Koral pointed out that insurance coverage will significantly change over the next 30 years.

He added: "This will also be seen in cyber coverage, which will inevitably expand in complexity."

By 2050, Koral predicted there will be a reorganisation of workers compensation, disability and personal accident coverage, as well as an expansion of employer responsibility in light of evolving definitions of discrimination and bias.

At the panel discussion, Koral used the example of autonomous vehicles to demonstrate how auto coverage is likely to change as innovative products develop. "These complex machines will require a different definition of negligence, product liability coverage for errors and omissions, cyber coverage against hacking, and maintenance contracts for cost of repair," he said.

Foley identified the current tools for change available are user-friendly technology capabilities, such as artificial intelligence and secure portals, as well as cost efficiencies, database development, and increasing demand from both consumers and businesses.

He added that over the next 30 years, the insurance industry as a whole will experience an accelerated rate of change as more services will be disintermediated, with the ability to buy, change or modify insurance directly.

In addition, Foley noted that alternative risk is likely to be consistently at the forefront of innovation, aiding the balance of growth and potential for increased regulatory oversight. He added that it will be important for domiciles to have the necessary resources to work with the private market, as well as receptiveness to new ideas.

In terms of captives, Koral viewed the structures as a solution to the chicken/egg dilemma of new businesses, whereby innovative startups cannot gain underwriting coverage with no track record, yet cannot operate without the coverage.

Koral concluded by recommending that when designing new insurance products, parent organisations "must carefully consider the bespoke risks they face, divided into third party and parent risks, but also understanding that these can overlap". ■

Troy University gives distinguished award to Edward Pappanastos

Troy University has awarded the 2020 Wallace D. Malone, Jr. Distinguished Faculty Award to Edward Pappanastos, scholar-in-residence with Arsenal Insurance Management and the associate chair of the department of risk management and data analytics at the Troy University's Sorrell College of Business. Earlier this year, Arsenal partnered with Pappanastos to build scholarship, engagement, and opportunities for both Troy University and Arsenal.

Arsenal also works with Pappanastos on several strategic recruitments and educational initiatives throughout the year to cultivate current and prospective risk management and insurance students and increase awareness of the opportunities available in the risk management and insurance industry, including the Alabama Captive Insurance Association's (ACIA) Risky Business internship programme.

Additionally, at this year's ACIA conference, there will be a focus on promoting student engagement by incorporating student-focused sessions and networking opportunities.

Commenting on this, Arsenal CEO Norman Chandler said: "Pappanastos has been instrumental in developing the Risky Business internship programme, and we are excited to have him as an asset to the Arsenal team. His extensive knowledge in the RMI industry and honourable reputation in the educational community made him the ideal person to bring in as a scholar-in-residence with Arsenal," he added.

According to Troy University, this award was established "to acknowledge those exceptional faculty members who, through meritorious and selfless service, transform vision into reality". ■

The keystone

Temple University's Michael Zuckerman discusses why now more than ever independent directors are important to captive insurance company governance

All organisations manage risk. Some manage risk better than others. All face a certain amount of risk not adequately treated by its current enterprise risk management (ERM) process giving rise to residual risk. The need to assess and manage residual risk is a cornerstone of ERM. Some would say that residual risk is an ERM opportunity to increase enterprise value.

A captive insurance company (captive) is a strategic risk management tool used by many organisations to manage risk and address residual risk. For example, the 2001 terrorist attacks on the World Trade Center in New York City focused risk managers' attention on the impact that a single event can have on multiple exposures across the enterprise. This event highlighted the need for a mature ERM programme to manage the interdependency of risk and the resulting residual risk. Captives are an essential strategic ERM tool that continue to evolve as organisations address an evolving and increasingly complex risk environment.

Captives are also privately held companies not generally subject to the same regulatory scrutiny as its publicly owned parent, for example. Single parent and group captives, however, are owned by public, private, and nonprofit organisations. A common thread among all captives regardless of its parent(s) legal structure is the obligation to manage the captive following best governance practices and standards that exceed regulatory compliance.

Some captive managers apply Sarbanes Oxley (SOx) principles to the management of a privately held captive to ensure that the proper controls are in place to prevent fraud, enable accurate financial reporting, and provide a superior level of governance. Moreover, there are multiple layers of captive regulation such as the domicile regulations, captive manager's financial reporting and compliance, actuarial loss forecasting and reserve certification, and the external audit. Why then is so much being written about the need for independent directors on captive boards?

The importance of independent directors for captive regulation and operation is growing, in part, because it can increase the likelihood that the captive parent(s) (member insured) will achieve its risk financing goals. Independent directors have proven successful in improving the member insured's governance. Why not provide the same benefit to the wholly-owned insurance subsidiary, the captive?

Successful organisations, for-profit or not for profit, are focused on meeting the needs of its stakeholders. To this end, organisations are focused on meeting environment, social, and governance (ESG) standards because it is the right thing to do, and will also improve an organisation's reputation, value, and access to capital. A captive's stakeholders include its member insureds third party claimants (customers, visitors, or patients), regulators, reinsurers, and service providers, among others. I would argue that the captive's stakeholders also include the member insured's investors, employees, vendors, credit rating agencies, community, and regulators. And all of them would have an interest in the successful operation of the captive. The captive's highest priority, therefore, is to protect the financial security of its member insureds increasing stakeholder value.

The current pandemic has proven how beneficial a captive can be to its member insureds as a source of capital in turbulent times. Why then put a captive at risk, unnecessarily, by not providing it with the benefit of an independent voice with the appropriate risk management expertise? The captive board has a legal duty to act in the best interest of the captive, but member insured operational factors can destabilise the board's decision-making process. The captive board can be influenced by factors unrelated to the captive's best interest because of their competing role as an officer or manager for the member insured, which can adversely impact liquidity and solvency. An independent director can prevent this from happening.

The Merriam-Webster dictionary defines 'independent' as "not subject to control by others". The Stanford University Business School Corporate Governance Initiative defines outside independent directors as outside directors with no "material relationship" to the company [including the member insureds or captive insurance company]. An outside director is one that is not an employee of the firm and contributes to the organisation by advising management on strategy and operations, drawing on their professional experience. Furthermore, they monitor the company to ensure that executives act in the best interest of shareholders. The New York Stock Exchange further defines an independent director as one who the board "affirmatively determines" has no "materiality relationship" with the company "either directly or as a partner, shareholder, or officer of an organisation that has a relationship with the company". Vermont, for example, does not require an independent outside captive board director but examines the character, reputation, financial responsibility, insurance experience, and business qualifications of the officers and directors or members of the governing board. Therefore, the independent director can bring stability to the captive management process because of her independence, integrity, and appropriate experience. To this end, the independent director must have the necessary governance, risk management, and alternative risk financing/transfer experience to be effective. Moreover, the effective independent director will:

- Assist the captive strategic planning process, including designing and creating solutions to manage the member insured's evolving risks
- Enable the captive board to analyse better and evaluate programme options
- Enable the captive board to avoid making decisions without regard to merit
- Be a trusted adviser that can act as a control against fraud
- Provide oversight for the captive's ERM programme

The Airmic 2019 Captive Governance Guide does an excellent job of explaining both the benefits of and the qualifications of an independent captive director. The qualified independent director will provide the needed balance, objectivity, and perspective to ensure that the captive not only meets its regulatory and stakeholder obligations but exceeds them. I would also argue that the independent director will improve the captive's ability to access underwriting capacity from the reinsurance and capital markets. Investors such as BlackRock and Vanguard examine an organisations' financial condition, cash flow, governance, sustainability, ESG data and ratings, among other material information, to identify and evaluate risk before investing its clients' money. Why wouldn't reinsurers seek ESG information about the captive and its member insureds before agreeing to commit its investors' capital to provide programme terms?

Some reinsurers are refusing to underwrite certain classes of business based upon ESG standards and incorporating ESG data into its underwriting process. Certainly, reinsurers are currently examining the governance and financial condition of a captive's member insured before offering terms. The presence of an independent director will improve the captive's case that it has strong leadership, governance standards, risk control, and protects its stakeholder rights and interests.

The current pandemic has taught us valuable lessons about business continuity management and resilience. Organisations will continue to use captives to design innovative risk management and risk financing solutions for evolving business continuity threats such as business disruption, cyber-attacks, and catastrophic property perils such as storm surge, to name a few. This innovation will require access to both reinsurance and capital markets. And the independent director will enhance this process.

Furthermore, the captive must provide economic, and risk management value to its member insured's while managing its own operational, financial, and strategic risks. An independent director acting in good faith without conflicts of interest will bring the necessary objectivity needed to reduce the captive's enterprise risk. An independent director can also be an arbiter to diffuse any potential differences between the captive board and its captive manager, actuary, auditor, and reinsurance broker. Again, the captive is a private company and not usually subject to the same regulatory scrutiny, depending on the domicile, that a publicly traded company would be in terms of governance, including the need for an audit committee.

Often, the full captive board acts as the audit committee, for example. An independent director, however, can take on the role of an audit committee, providing an objective and disinterested conduit for the captive service providers much the same way that a formal corporate audit committee does for whistleblowers and the internal and external auditors.

I would think that the member insured's audit committee would want the captive to provide this control against possible fraud, and other governance failures. A well-governed captive must manage its underwriting, compliance, reinsurance credit, liquidity, and solvency risks without concern for the member insured's budget and cost of risk allocation issues.

Moreover, the member insured's board, whether the organisation is publicly traded, private, or not for profit, has ultimate responsibility for the oversight and governance of the entire enterprise, including its captive. Boards must ensure that the organisation is addressing its material risks. If the captive board loses its objectivity threatening its liquidity or solvency, it could trigger a credit rating review or event-driven liability for the member insured's board.

There are several potential drawbacks to using independent directors.

An independent board member may not be as familiar with the member insureds operations, operational and strategic risks as would an inside director. Inside directors can also co-opt an independent director.

Furthermore, an independent director may not be qualified to advise on captive insurance operations. The member insured can overcome these potential drawbacks by selecting the appropriate individual.

The Airmic 2019 Captive Governance Guide does go into some detail about how the independence of independent directors can be impaired.

The question, however, should not be whether an independent director is an appropriate governance standard for a single parent or group captive, but how do we manage the risk that an independent director's independence could become impaired.

"The independent director, if responsibly managed, will provide the necessary stability needed for innovative and effective captive insurance programmes"

Michael Zuckerman

Associate professor

Temple University Fox School of business

The Airmic guide does provide this guidance. The member insured, for example, should assess the board performance annually, establish term limits, and avoid selecting an independent director with any close family ties to the captive board, vendors, or member insured employees involved with the captive operation.

In conclusion, the independent director, if adequately vetted and managed, at the very least, should positively impact the captive's access to underwriting capacity as well as the acquisition and cost of directors' and officers' liability insurance for the captive board.

Moreover, it will provide the control needed to ensure that the captive will have the solvency and liquidity to be there to support its member insured's business continuity recovery from the next adverse event that impacts the entire enterprise.

The independent director, if responsibly managed, will provide the necessary stability needed for innovative and effective captive insurance programmes. ■

Adapting to change

Malta has a strong grip on the captive market in Europe, especially in PCCs, but as uncertainties surrounding COVID-19 play out, the country looks at how it can adapt to remain competitive

Malta is a small island nation located in the Mediterranean Sea just south of Italy with a population of about 450,000. For a small country, Malta has a lot to offer, and not just for the millions of tourists that visit each year. The country also boasts a well-established insurance sector operating for both domestic and international clients.

Malta established its captive insurance market in 2003 and as of 2019, it was home to 62 captives.

Being a member of the EU, Malta is entitled to EU single passport right, which means any captives that are based in Malta, can provide insurance in the other EU/EEA member states using their Maltese license without having to apply for a separate license in each of their chosen countries.

However, like all EU members, Malta has to adopt and follow the Solvency II Directive, an EU law that codifies and harmonises the EU insurance regulation, which came into effect in 2016. The directive is the first common supervisory framework in the EU and sets global standards. It sets the basis for the integration of the single market for insurance in Europe.

The system is based on a forward-looking and risk-based approach, requiring the highest risk management standards and active monitoring and steering of the risk an insurer is facing. It ensures fair competition and consistent consumer protection across the EU and allows insurers to provide their product cross-border.

However, Solvency II has added a lot of complexity to the process and structures of companies and supervisors, presenting a significant regulatory burden. Which is why the current Solvency II is under review. The EU launched a consultation on Solvency II review earlier this year and will release their feedback at the end of 2020.

Commenting on the Solvency II review, Julian Boffa, regulatory advisor at Ganado Advocates, says "it is still early days to fully understand the impact of the Solvency II review on Malta's insurance industry."

However, he suggests initial reactions "seem to be positive vibes, particularly as the review addresses several topics, including aspects of proportionality and better practicality in the regulatory interaction between operators in the industry and the regulator, which should improve things for the typical operator size normally found in the Maltese market".

PCCs

Malta's biggest selling point is its protected cell companies (PCCs) market, this is because Malta is the only full EU member state that has PCC legislation, which came into force in 2004.

A PCC is a corporate structure in which a single legal entity consists of a core linked to several cells that have separate assets and liabilities. The central core organisation is linked to individual cells and each cell is independent of each other and the company's core, but the entire unit is still a single legal entity. A PCC is sometimes referred to as a segregated portfolio company.

Ian-Edward Stafrace, chief strategy officer at Atlas Insurance PCC, explains that he has reviewed hundreds of enquiries since it came into force most of which intended to directly write to consumers.

He continues: "Potential cells most likely to be feasible are cells with expected premium volumes in excess of €1 million."

"We have seen smaller exceptions where loss ratios are predictably very low or where the cell is needed for more strategic reasons. The best fits are usually focused on one or a very small number of products with low limits or event exposures and covering short-tail risks, with limited if any liability exposures included," he adds.

Cell captives will remain popular solutions for captives because of the economies of scale they offer, according to Boffa.

He notes: "Many a time, captives' main struggle, particularly in the initial phase, is resource requirements, including technical resources."

"Solvency II has introduced very heavy governance requirements which might be very onerous for smaller captives. Cell solutions are therefore ideal as the governance burden is taken care of by the PCC core", he adds.

Small but mighty

Looking at how Malta can keep competitive in the captive market, Stafrace explains that the Maltese government is keen to make Malta a blockchain capital of Europe with the creation of the Malta Digital Innovation Authority and a framework for the voluntary certification of distributed ledger technology and related service providers.

He says: "This intends to offer legal certainty in a space that is otherwise unregulated and touches upon several issues including types of authorisations, legal personality, and the applicability of law on smart contracts."

Stafrace suggests that with these developments and having full access to the EU single market, cells based in Malta can be "ideal digital insurers".

PCCs can be seen as sandbox platforms to experiment, incubate, launch and scale new technology-driven business models at a far lower cost and capital than a standalone insurer.

Stafrace adds: "They help break the barrier to entry for new captives or start-up insurtechs unintentionally created by regulation."

"These are exciting times with the financial services community merging with the tech start-up community to shape the future of the sector."

Boffa notes that the MFSA has an ongoing consultation process which will result in the issuing of guidelines in relation to technology arrangements, ICT and security risk management and outsourcing arrangements.

He states: "The developments on these guidelines is certainly a topic which should be followed by captives, insurance undertakings and intermediaries alike, as high new governance benchmarks will be probably set."

Adapting to new realities

The captive market is always heavily influenced by the ongoing realities of the parent companies and the groups within which they lie.

Commenting on this, Boffa notes that the enforced COVID-19 lockdowns across the world have and will continue to have a significant impact on the different markets.

He says: "The captive market will need to adapt to the new realities which will face it moving forward."

"We are seeing mergers of large international groups and which naturally result in consolidations at the captive level as well, but at the same time mergers are a time of opportunities."

"The trend is normally for captives to exploit such opportunities rather than shrink operations. This is possibly leading to the trend of captives to look at their parent's customer base and branch out (or expand) non-pure captive offerings", he adds.

He explains that Malta's small size has always meant that rapid adaptation was a "strong point" in its approach to the challenges facing it.

Malta's future suggests that the country's reactivity to challenges is certain to mean further growth in the local captive industry, according to Boffa.

The uncertainties surrounding COVID-19 are not expected to disappear any time soon, Boffa highlights that the jurisdictions that are first to adapt to the new realities "will be the ones who can best accommodate the new projects and objectives of the captive industry".

"On that basis, Malta should certainly be at the top of the list when it comes to the selection of a jurisdiction where captive owners wish to invest in to host their captive solutions," Boffa concludes. ■

With costs continuing to increase in the American healthcare system, so does the pressure of companies to provide their employees with their healthcare programme. With unforeseen claims and costs, the industry is seeing a rise in businesses considering a medical stop-loss captive

US healthcare spending is set to reach $4 trillion in 2020, according to a report by the Centers for Medicare and Medicaid Services (CMS) from earlier this year.

In the same report, the CMS estimated that US national healthcare spending reached $3.81 trillion in 2019. It also projected that by 2028, healthcare spending would reach $6.19 trillion, and would account for 19.7 percent of GDP, an increase of 17.7 percent in 2018.

With such high prices, those living in the US, who can afford it, generally have health insurance. In order to help keep costs down, a lot of Americans are insured through their employer. Companies in the US have turned to captive insurance as a way to insure employees, making healthcare plans a popular employee benefit.

However, as more companies take control of their employees' healthcare, it has created a lot of room for the uncertainty of unexpected or large claims that weren't accounted for and the rising costs of healthcare. This is just one of the reasons that healthcare captives are quickly becoming a vehicle of choice for medical stop-loss (MSL) exposures.

The US Department of Labor (DOI) does not recognise MSL as an employee benefit as the coverage because it does not directly insure the employees. MSL coverage indemnifies the employer for its claim obligations to the self-funded plan that it takes out.

MSL coverage consists of two parts: specific and aggregate.

Specific coverage protects the employer from large, catastrophic claims or a series of claims attributable to any individual covered by the plan in any one year. While the

 images by atstock_productions/stock.adobe.com aggregate coverage protects the employer against an unusual amount of claims frequency attributable to the entire group of covered members.

Benefits

One of the main reason programmes were set-up initially, according to Jarid Beck, director and co-founder of Risk Management Advisors, a division of Risk Strategies, was to address the issue of access and capacity.

In the traditional health insurance market, there are not that many options. As there are only five to six carriers operating in any given region, and they increase rates every year and recycle conventional products.

Beck explains that many employers would like to exit the traditional market and self-insure where they can control their plan, stabilise cost and recoup underwriting profit.

He says: "A key component in making this feasible is obtaining stop-loss insurance because it can be difficult to find a carrier to issue favourable terms to a company coming out of the traditional market," adding that "MSL captives bridge that gap".

"The other big benefit is savings. In the captive, the insured employers are the owners. If the captive is profitable then they will receive profit dividends, which reduces the overall cost of the plan," Beck adds.

Also weighing in, Michael Schroeder, president of Roundstone, adds: "Self-insuring opens a tool kit of cost containment strategies that are not available in the traditional fixed cost insurance market. MSL captives deliver transparency, control and cost savings."

Less bang for your buck

MSL is not just for larger corporations, with the combination of rising healthcare costs and continued regulatory uncertainty, more small-to-medium sized companies are switching to self-funding. Philip Giles, managing director, MSL Captive Solutions, explains that due to those circumstances, the use of group captives will continue to expand.

Giles suggests that the traditional MSL market itself will experience a "noticeable firming of rates" across most segments in 2021.

"Overall market performance in this line of coverage has not been favourable over the past several years, and many carriers will be looking to ameliorate their underwriting results," he says.

"This will further encourage more employers, especially 'good risks' – those having an established track record and favourable loss history as a self-insurer – toward group captive participation."

Larger employers are also set to increase their specific deductibles and cede more risk to single-parent captives.

Giles adds: "Again, being able to distance a self-funded employer from relentless market volatility will increase the attractiveness of MSL captives."

In 2010, during his time as president, Barack Obama passed the Affordable Care Act (ACA), also known as Obamacare, with aims to make Medicare much more accessible to people who struggled to afford insurance.

Beck suggests that ACA has been a "contributing factor" to companies considering an MSL captive.

He explains: "The ACA was designed to lower or control cost. That didn't happen and you can point to provisions in the law that have had the opposite effect, causing cost to increase."

In addition, Schroeder expresses that the ACA was "the match that lit the forest fire" of stop-loss group captives, but noted that today, the primary driver of stop-loss captive growth is the rising cost of traditional health insurance.

Beck paints the medical loss ratio (MLR) as a good example. "Just as employers are recognising that relying on the carriers to lower cost is not a recipe for success, so too is the realisation that regulation is unlikely to shake out in their favour," he says.

Three broad variations

The MSL group captive market has three broad variations: heterogeneous programmes, homogeneous group programmes, and high performer groups.

Heterogeneous programmes are a wide variety of industry classes and generally require more employers to achieve an appropriate spread of risk among its diverse membership. The larger size and risk spread are necessary to mitigate the increased risk variability, and the potential for increased underwriting volatility, caused by differing demographics among the participating employer populations.

Giles comments: "Most group captive market growth has emanated from heterogeneous 'open-market' captive programmes, representing the largest segment of the group MSL captive market."

> *"The fact captive participants keep premiums they don't spend has benefited the employers during the dramatic downturn in elective medical procedures. A stop-loss captive's flexibility and control also allow for quick responses to a changing healthcare marketplace"*

The average member size within this category generally is smaller than in other group captives and is typically between 50 and 250 employees.

Giles adds that these programmes primarily target fully-insured employers and use the group captive programme as a conduit to ease the transition to self-insurance for smaller employers.

On a homogeneous group programme, Giles outlines that they can be smaller because their underlying risks and underwriting profiles are similar, so the size needed to achieve an appropriate spread of risk is not as large as it is with heterogeneous groups.

The average member size is typically larger than in heterogeneous groups and generally targets existing self-insurers having between 250 to 500 employees.

Finally, on high performer groups, Giles describes that they can be either heterogeneous or homogeneous in terms of composition.

He states: "As its name would imply, a high-performance captive would be open only to established self-insurers with a consistent track record of exceeding specific performance benchmarks."

Reflecting on the most popular structure, Giles suggests that in terms of the number of employers and premium volume, the open-market programmes represent the largest segment of the group MSL captive market.

"Although the composition profile of each type of group captive may be different, the primary objectives of each centre are stabilising the cost of medical stop loss and reducing the ultimate cost of healthcare benefit delivery," he adds.

COVID-19 increase

With the ongoing COVID-19 pandemic still affecting people worldwide, how can MSL programmes help to businesses for similar future events?

Schroeder suggests there will be an increase as MSL captives have "proven to be a strong performer during the pandemic".

He explains: "The fact captive participants keep premiums they don't spend has benefited the employers during the dramatic downturn in elective medical procedures. A stop-loss captive's flexibility and control also allow for quick responses to a changing healthcare marketplace."

"Virtual medical care such as telemedicine services are quickly accessible for employees and their families when their employer insures the health plan under a stop-loss captive arrangement", he adds.

Beck echoes Schroeder's belief that this pandemic and economic crisis will increase MSL, stating that "during periods of economic crisis, it is normal for businesses to take stock and evaluate where they can be leaner, smarter or more efficient".

"For most middle-market companies, group medical benefits are the second-largest expense after payroll, making it ripe for analysis. MSL captives are a viable alternative", Beck adds. ■

Ryan Peruski

Partner

Honigman

"The best advice I could provide someone is to read everything you possibly can in connection with captives (for example, legal cases, tax court cases, industry periodicals, IRS guidance and domicile updates and regulations) and to seek out strong mentors in the captive industry"

Personal Bio: As a native of Ubly, a small farm town in Michigan's thumb area, I have a passion for supporting Detroit sport teams and enjoy outdoor activities including hunting, hiking, boating and most of all, golfing.

My love for Detroit sports and the outdoors does not come close to the love I have for my wife and daughter (baby number two is arriving soon). My favourite pastime is reading Brown Bear to my daughter, Claire. Being a husband and a father is the most rewarding experience of my life.

Professional Profile: For my undergraduate education, I majored in finance at Saginaw Valley State University. I later went on to receive my law degree from Michigan State University.

Following law school, I started my career at Ernst & Young where I worked with some of the world's largest companies on various tax matters. After four years at Ernst & Young, I transitioned to Honigman and have been practising tax law in the firm's insurance department, where I have spent the last five years.

Outside of my insurance and captive tax work at Honigman, I serve as a council member for the taxation section of the State Bar of Michigan.

How did you end up in the captive industry?

My path towards the captive industry was a 'happy coincidence'. When I originally applied to Honigman it was for a position in their corporate tax practice; however, after my interview, the firm asked if I'd be interested in interviewing for a tax attorney position within the insurance department. I knew very little about insurance and captive taxation at the time but joining the group was one of the best decisions I have ever made. For the last five years, I have enjoyed the work and analysing captive insurance arrangements, handling tax controversies and planning for certain cross-border transactions.

What has been your highlight in the captive industry so far?

The best part of being in the captive industry is developing lasting relationships with clients and helping to solve complex captive tax issues. It's a rewarding experience developing creative solutions and it makes the job worthwhile when you can have meaningful conversations with clients and co-consultants.

What/who has been your influence in the captive industry?

The two people that have been stewards in the success of my career in the captive industry would be Mike Domanski and Julie Robertson. Mike has been my mentor since day one at Honigman. He has taught me volumes about captive taxation and is always available if I need guidance or help with a complex issue. Julie, the chair of the insurance department, has been very instrumental in my development from a non-tax perspective and has given me the confidence to counsel and communicate effectively with clients.

What is your impression of the industry?

The captive industry is extremely dynamic and invigorating. From a tax perspective, the captive industry seems to be in the midst of stormy waters with the Internal Revenue Service (IRS) winning certain recent captive tax cases and scrutinising micro-captive transactions. These issues, coupled with recent tax law changes (under the Tax Cuts and Jobs Act in 2017) and increased state tax implications, have forced us and our clients to be proactive and nimble. From a non-tax perspective, it will be interesting to see how the current pandemic impacts captives and their shareholders, and how captives might be used to assist our clients to navigate through the current health crisis and during a hardening market.

What are your aspirations for your career in the captive industry?

As a tax attorney in the captive industry, my aspirations are to continue to provide value and creative solutions to clients and to continue building genuine, lasting relationships with clients and co-consultants.

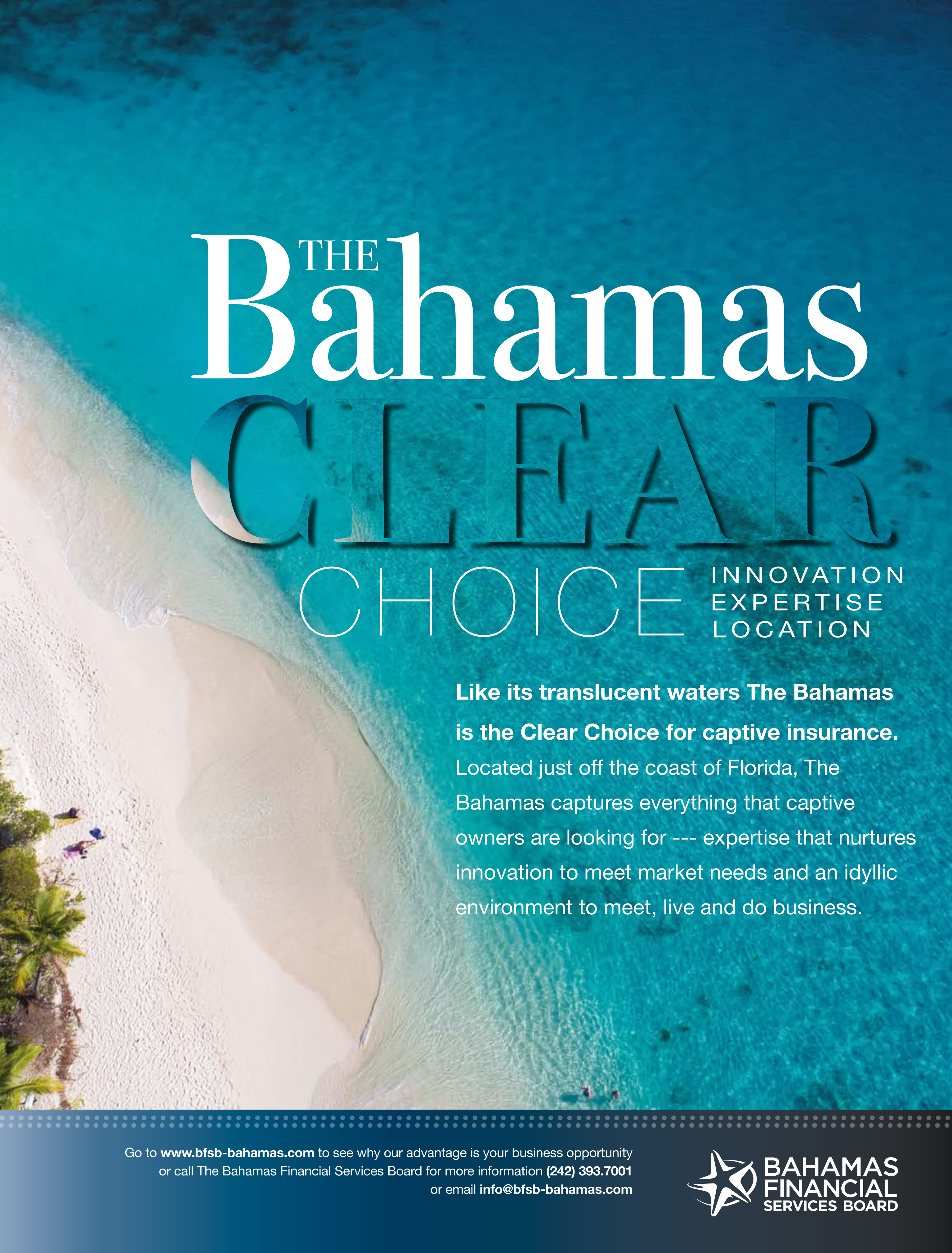
What advice do you have for someone considering a role in the industry?

The best advice I could provide someone is to read everything you possibly can in connection with captives (for example, legal cases, tax court cases, industry periodicals, IRS guidance and domicile updates and regulations) and to seek out strong mentors in the captive industry. ■

"Ryan has provided tax counsel to our wholly-owned captive since we relocated to the Cayman Islands in 2017. The move to the Caymans involved merging an existing Vermont captive into the newly-created Cayman captive, and required more discussions, tax and otherwise, than simply forming a new company. Ryan, along with his firm, Honigman, has been a trusted partner every step of the way.

Where Ryan has stood out to our organisation is in his ability to guide and educate our inhouse accounting leaders and staff through the complicated accounting and tax questions that have arisen. This has been the first exposure to captive insurance and its tax and accounting principles for the entire accounting department, and Ryan's expertise and patience have smoothed the bumps in the road along the way. As the non-accountant insurance leader, I am personally grateful for Ryan's ability to explain concepts that I struggle with. We want to be intelligent captive owners and use our captive to its fullest, and Ryan's ability to educate us and be patient as we learn is a valuable contribution to those aspirations."

Keith Lindloff, director of risk finance at Children's Health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The captive division of the South Carolina Department of Insurance (SCDOI) has promoted Dan Morris, Greg Delleney, Eva Conley and Lauren Robertson.

Morris has been named as the new deputy director for financial regulation and solvency as Lee Hill retires. In his new role, Morris will be responsible for the captive division as well as the analysis and examination of traditional companies.

His most recent role was deputy director of the agents licensing and continuing education division and previously served in various financial analysis roles within the captive division.

Elsewhere, Delleney was promoted to assistant director of captives and is now responsible for application reviews, prospect coordination and domicile promotion.

Delleney will also continue to serve as a chief financial analyst for the captive division.

Conley will take on the role of supervising financial analyst. She will be responsible for overseeing the work of all financial analysts in the captive division and assists with reviewing licensing applications and complex business plan changes.

Finally, Robertson was named as the new business plan change analyst. Robertson takes on the responsibility for reviewing and analysing proposed changes to captives' plans of operations and also assists with reviewing licensing applications.

Commenting on the promotions, Ray Farmer, director of the SCDOI, said: "The changes we have made in the recent months only further our ability to serve the public."

Farmer continued: "These individuals have been strong public servants in their previous roles in the department and it was my pleasure to promote them to their new positions where they will continue to serve in the best interest of our state."

Jay Branum, the director of the captive division noted: "We all remain committed to delivering the highest level of professional service to our clients in terms of quality of service, depth of industry knowledge, and overall soundness of reputation." ■

Risk Strategies has named Jennifer Johnston as chief marketing officer.

In the newly created position, Johnston brings experience in branding, marketing and communications within the insurance industry, consulting and professional services as well as technology.

Johnston joins Risk Strategies from CopperPoint Insurance where she served as executive vice president and chief marketing officer.

Prior to that, she served as chief strategic marketing officer for PMA Companies/Old Republic Insurance Group, and vice president of marketing for Unisys Global Industries with global marketing responsibility for financial services, public sector, and commercial industries practices.

Sharon Edwards, Risk Strategies' COO said: "Jennifer Johnston is highly experienced, both in marketing and insurance, and we're excited to welcome her to Risk Strategies."

She added: "She will be instrumental in helping us generate demand for and recognition of the company, its products, and services. She will be focusing on integrating and unifying our brand across all channels, enhancing the client experience and value proposition for Risk Strategies' speciality practices and developing the strategic marketing actions we need to execute as we continue to grow and scale our business domestically and internationally." ■

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The National Safety Council (NSC) has appointed Mark Baker as vice president of workplace, for the non-profit safety organisation.

Based in its Chicago headquarters, Baker will be responsible for leading membership, thought leadership and workplace product offerings.

For members, he will focus on increasing value and engagement for more than 15,000 of the council's member organisations.

Baker will oversee the Campbell Institute and Work to Zero programmes, along with workplace research, to driving workplace safety thought leadership.

He also will be responsible for NSC workplace products and services, including the COVID-19-related safe actions for employee returns initiative, as well as drive enhancements to workplace safety products and training services.

Additionally, he will assist with the launch of NSC Marketplace, a new customer portal for safety products and services.

Baker joins NSC from Hyatt, where he serves as global director of workplace safety and vice president of global risk.

At Hyatt, Baker focused on strategically managing workplace safety and risk management impacting Hyatt's portfolio of hotels and colleagues globally. He also developed and lead its captive insurance business.

Commenting on his new role, Baker said: "I'm thrilled to join NSC, where I can merge my passion for safety and risk management with my strategic business background to help build NSC to be the authority in workplace safety."

He continued: "Throughout my career, I have demonstrated my passion for keeping workers safe, and I will bring that commitment to NSC as we work to eliminate preventable injuries and deaths in the workplace."

Lorraine Martin, NSC president and CEO noted: "Mark Baker has more than 30 years' experience leading and developing successful global, safety-related business organisations. He has a rich depth of experience with a successful track record in workplace safety and risk management, as well as captive insurance business leadership." ■

Erick Mortenson has joined Pinnacle Actuarial Resources as a consulting actuary in Denver.

Mortenson joins from Willis Towers Watson (WTW), where he was a senior vice president.

At WTW, he focused on providing analytics solutions in areas including reinsurance and medical professional liability.

Prior to that, Mortenson worked in a similar role for Aon Benfield in Minneapolis.

Commenting on his new role, Mortenson said: "I'm looking forward to working with Pinnacle's outstanding team and terrific clients."

"The firm has a tremendous reputation for doing outstanding work. But it's also known for innovation and making important contributions not only to the health of the insurance industry but to the growth of the actuarial profession. I couldn't be more pleased to join Pinnacle," he added.

Pinnacle managing principal Joe Herbers noted: "We're very pleased to welcome Erick Mortenson to Pinnacle. His extensive data science and predictive analytics background enhance the strength of our predictive analytics team. He is an accomplished team leader and project manager and possesses the financial expertise that is a great additional value for our clients." ■