

The logo for Airmic, featuring the word "airmic" in a lowercase, white, sans-serif font. A thin white horizontal line is positioned directly beneath the text.

airmic

GUIDE 2023

Captive Governance

A Practical Guide for Independent Non-Executive
Directors on Captive Boards

IN ASSOCIATION WITH:

The Aon logo, consisting of the word "Aon" in a bold, white, sans-serif font. The letter "A" is significantly larger and more prominent than the "o" and "n".

Aon

Acknowledgements

About Aon

Aon plc (NYSE: AON) exists to shape decisions for the better — to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries and sovereignties with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.

ADDITIONAL INFO

© Aon plc 2023. All rights reserved.

The information contained herein and the statements expressed are of a general nature and are not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information and use sources we consider reliable, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Aon UK Limited is authorised and regulated by the Financial Conduct Authority.



About Airmic

The leading UK association for everyone who has a responsibility for risk management and insurance in their organisation, Airmic has over 450 corporate members and more than 1,800 individual members. Individual members are from all sectors and include company secretaries, finance directors, and internal auditors, as well as risk and insurance professionals. Airmic supports members through learning and research; a diverse programme of events; developing and encouraging good practice; and lobbying on subjects that directly affect our members and their professions. Above all, we provide a platform for professionals to stay in touch, to communicate with each other, and to share ideas and information.

www.airmic.com

The Airmic logo, consisting of the word "airmic" in a lowercase, white, sans-serif font.

Airmic guides are provided to give an insight and some understanding into different areas of risk. They are not intended to address any particular requirements or issues. Airmic guides are not intended to replace the need for advice nor are they training guides. Airmic does not accept any liability for the content of the guides which are prepared based on the views of the author (who may not be an Airmic employee).

Every organisation should have an objective to implement good practice for corporate governance. Captive insurance companies are no exception.



Airmic is delighted to publish this Guide produced in partnership with Aon plc and informed by contributions from Airmic members. As captive insurance companies become more sophisticated and attract increasing levels of parental and regulatory scrutiny, the role of and independent non-executive directors (INEDs) in various captive domiciles on the board has continued to grow and play a central part in the development of effective levels of governance and the provision of advice and expertise with specific specialities.

The Guide is designed as a resource for individuals currently serving as directors on captive boards or considering an appointment in the future. It suggests a range of simple but important steps that can be taken to ensure captive company board oversight is fit for purpose, and it contains valuable information for captive managers and captive owners when considering new appointments to the board. The Guide is also relevant for risk professionals who want to evaluate the effectiveness of their captive's board and independent non-executive directors (INEDs).

Julia Graham
CEO, Airmic

Introduction	6
What is an iNED?	7
What benefits do iNEDs bring captive insurance companies?	8
Are iNEDs compulsory for captives?	12
Who qualifies as an iNED?	14
What is the process for iNEDs once appointed?	16
How is an iNED's performance measured and can they be removed?	17
Term, remuneration and D&O cover	18
Can more than one iNED serve on a captive board?	19
Five key takeaways for iNEDs	20
Five key takeaways for captive owners	21

Introduction

Airmic, in partnership with Aon, originally launched its Captive Governance Guide in 2019, just as a hard insurance market was bringing captive insurance back to the forefront.

Four years on, a lot has changed. The hard market has continued to challenge risk and insurance managers, applying more pressure to find new solutions, which has often included further utilisation of captives.

The pandemic was an opportunity for many captives to support their groups by releasing capital back to the parent, while specific challenges concerning cyber, directors and officers insurance, and ESG mean conversations in the captive's boardroom have evolved too.

While the major captive domiciles we spotlight (see page 7) have not formally amended their requirements for independent non-executive and resident directors for captives over the past four years, the approach of regulators is changing.

Across domiciles, regulators are paying more attention to board make-up to ensure independent guidance and advice is being presented when required. Increasingly, they are scrutinising the number of board appointments per director too.

A captive's board, when composed of a combination of appropriate individuals from the insured and expert independents, plays an essential role by holding the captive's operation to account, providing independent oversight and expert insight. Independent directors are key to demonstrating and delivering the substance, good governance and independence increasingly demanded from regulators and tax authorities around the world.

Captive boards commonly contain representatives from the parent organisation. Captive non-executive directors provided by the parent's treasury, legal or company secretariat function may provide an independent view from the risk and insurance management function, but their employment by the captive's key (or only) policyholder means that true independence must be sought further afield.

It is the role of these independent non-executive directors (iNEDs) that is the subject of this Guide.

There is no prescriptive or 'one size fits all' approach to forming or refreshing a captive board, but this guide has been designed as a resource for individuals currently serving as directors on captive boards or considering an appointment in the future. The guide also contains valuable information for captive managers and captive owners when they are considering new appointments to the board.

“The role of the iNED is to demonstrate that they are bringing independent advice, guidance and objectivity, and this should be evident from board papers and minutes.”

Ann O'Keefe, Chief Risk Officer, Aon Captive & Insurance Management

What is an iNED?

In the corporate world, an iNED (also known as an outside director) is an individual who is a director (member) of the board of directors and who does not have a material or pecuniary relationship with the company or related persons, other than sitting fees.

“Apart from their director’s fees and shareholdings, they should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. It is for the board to decide in particular cases whether this definition is met,” according to the 1992 Cadbury Report,¹ which has influenced the UK Corporate Governance Code. The iNED’s role is to provide a creative contribution to the board by providing independent oversight and constructive challenge to the executive directors.

The 1992 Cadbury Report initiated a debate about the main functions and responsibilities of non-executive directors and iNEDs. Today, it is widely accepted that iNEDs have an important contribution to make to the proper running of companies. As the Cadbury Report stated regarding non-executive directors more broadly, “[they] should bring an independent judgement to bear on issues of strategy, performance and resources including key appointments and standards of conduct”². This is just as true for independent non-executive directors.

There is no legal distinction between executive and non-executive directors. As a consequence, in the UK unitary board structure, NEDs and iNEDs have the same legal duties, responsibilities and potential liabilities as their executive counterparts. Clearly,

it is appreciated that iNEDs cannot give the same continuous attention to the business of the company. However, it is important that they show the same commitment to its success as their executive colleagues.

The UK Corporate Governance Code views a director’s independence as being potentially impaired if they:³

- are or have been an employee of the company or group within the last five years
- have, or have had within the last three years, a material business relationship with the company or group, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company or group
- have received or receive additional remuneration from the company or group apart from a director’s fee, participate in the company’s share option or a performance-related pay scheme, or are a member of the company’s pension scheme
- have close family ties with any of the company’s or group’s advisers, directors or senior employees
- hold cross-directorships or have significant links with other directors through involvement in other companies or bodies
- represent a significant shareholder, or
- have served on the board for more than nine years from the date of their first appointment.

¹ The 1992 Cadbury Report. Section 4.12.

² The Cadbury Report. Section 4.11

³ UK Corporate Governance Code, Financial Reporting Council

What benefits do iNEDs bring for captive insurance companies?

Due to a captive's size and function, its board size is typically smaller than that of a traditional corporate board. However, it must still fulfil the same functions as any other corporate board and provide oversight on finance, legal, risk and insurance, and governance. Other directors will usually be provided by the parent – they may come from the risk and insurance, legal, treasury, finance or company secretariat function. The captive manager may also be represented on the board, but they would not qualify as an iNED.

An independent director will provide independent thought, question the decisions of the captive and challenge the quality of service provision. They can also be used to fill essential skills gaps or provide broader insight into the sector the company is active in.

The iNED will provide an extra pair of eyes to ensure that all corporate governance and

compliance requirements are being met sufficiently and to ask questions above and beyond a compliance-led approach.

Depending on the expertise and insight that they bring to the board, they should ask questions or probe areas that would otherwise have gone unaddressed by other directors. If the iNED is a claims specialist, for example, they may take the initiative to visit the claims-handling department servicing the captive to gain greater insight and provide feedback to the board. This should be a 'walking the floor' exercise without interfering with the management of the parent or the captive suppliers.

A truly independent and proactive iNED will also assist the company in demonstrating to the local regulator that the captive takes its governance requirements and role as a regulated entity seriously.

“A captive can be a very flexible tool, but they are not always fully utilised. An independent director should attend with an open mind and their experience can help the captive on its journey and deliver maximum value.”

Malcolm Cutts-Watson, Guernsey iNED



New areas for iNEDs to consider

Over the past four years, several topics have risen in prominence for both captive owners and regulators. Cyber, ESG and D&O are all hot topics, relevant for both the governance and day-to-day operation of the captive, as well as the role it may be asked to play in risk financing for the group. Below are important considerations for iNEDs in these areas:

Cyber

The majority of domiciles and regulatory regimes have published or updated their cyber guidelines and regulations in recent years. In 2021, the Guernsey Financial Services Commission (GFSC) published its Cyber Security Rules and Guidance, which must be followed by all captives and insurance managers.

In the European Union, there are EIOPA *Guidelines on Information Communication Technology (ICT) Security & Governance*, published in October 2020. The Digital

Operational Resilience Act (DORA) – Regulation (EU) 2022/2554 will not be in place until January 2025 but is expected to impact captives.

- For self-managed captives, it is important to ensure appropriate frameworks, procedures and controls are in place to mitigate cyber risks and that appropriate recovery processes are in place.
- For captives that outsource management, outsourcing agreements should address some important elements of responsibility for cyber security of captives. Directors do have various responsibilities with respect to outsourcing, so they should be aware of and review the cyber security policies and procedures put in place by the captive manager.

There is also a growing trend of captives insuring the cyber risk of their parent or playing a role in its cyber insurance programme. Independent directors should be prepared to scrutinise and challenge the captive's role in such programmes, as they would for any other new risk entering the captive.

“Directors must pay attention to cyber security. The captive may hold or have access to sensitive data of the group and/or its employees, for example, financial information or personal data if it is insuring employee benefits.”

Francoise Carli, Luxembourg iNED

ESG

As environmental, social and governance (ESG) topics rise up the corporate agenda and become increasingly prioritised, the captive board, including iNEDs, must ensure it is up to date with the group's ESG goals and principles. If not already presented with such information, the board should request updates from the group as to its ESG policies and targets so it can assess how the captive can contribute.

Some domiciles are taking a pro-active approach to help captives think about the role they have to play in ESG. In 2021, the Guernsey International Insurance Association (GIIA) launched an ESG Framework for Insurers, which several captives in the jurisdiction have voluntarily signed up to.

Three captives, domiciled in the Netherlands, Switzerland and Singapore have signed up to the United Nations' Principles for Sustainable Insurance (PSI) in the last 18 months.

In the EU, the European Commission published the *Commission Delegated Regulation (EU) 2021/1256*, which came into effect in August 2022, to address the integration of sustainability risks in the governance of insurance and reinsurance undertakings.

EIOPA, in 2022, also issued optional guidance for running a climate change materiality assessment and using climate change scenarios in the Own Solvency Risk Assessment (ORSA).



D&O

The importance of, and considerations for, securing insurance for captive directors and officers is addressed on page 12. At the height of the recent hard D&O market, however, there was significant discussion of captives taking part in their parents' group D&O programmes.

While captives have previously been used to insure Side B and C risks, albeit rarely, the possibility of providing indemnity for Side A gained greater prominence when Delaware amended its corporate code to expressly allow the use of a captive for most Side A risks, in February 2022.

Social networking giant Meta is the first known example of a Delaware corporate using, in this case, its Hawaii-domiciled captive to insure Side A risks. There has been at least one further example of a Delaware business taking advantage of this rule change to insure Side A in its captive.

For captives insuring UK corporates, the Companies Act 2006 must be considered since UK company law is silent on whether captives can or cannot insure the group's Side A exposures.

"For some of these risks, risk management through insurance is permitted, when a corporate indemnity is not," says Sarah McNally, partner at Herbert Smith

Freehills. "A question which is therefore often asked is whether insurance from a captive is itself a corporate indemnity by another name so as to trigger this prohibition."

Captive directors should consider two key questions if the group is considering a similar approach to Side A:

- Does the relevant captive domicile's corporate code allow directors of the captive to be insured/indemnified by the same entity?
- If not, has the policy been structured so captive directors are covered in a separate policy?

"While on the face of it a properly managed captive is providing insurance, the answer as to whether there is an infringement will likely depend on how the captive is organised, funded and operated. It is only if on the facts there is no such prohibition that questions of practical consideration arise."

Sarah McNally, Partner, Herbert Smith Freehills

Are iNEDs compulsory for captives?

It depends on the jurisdiction in which the captive is domiciled. United Kingdom Plc-owned captives are regularly found in Guernsey, the Isle of Man and the Republic of Ireland, and occasionally in a handful in other locations, principally Malta, Gibraltar, Luxembourg, United States domiciles, Bermuda, Cayman Islands and Singapore.

The table below outlines where iNeds are compulsory and the relevant guidance for each jurisdiction:

Domicile	Is an iNED required?	Is a resident director required?
Bermuda	No	No
Cayman Islands	No	Yes
Guernsey	Yes	Yes
Ireland	No	Yes (European Economic Area)
Isle of Man	Yes	Yes
Luxembourg	No	No
Malta	Yes	Yes
Switzerland	Yes*	Yes
Vermont	No	Yes

*For captive reinsurers with a C3 licence, an exemption can be requested from the Swiss Financial Market Supervisory Authority (FINMA) and is always approved. An exemption is not feasible for larger captive reinsurers and direct writers with a C1 licence.




Who qualifies as an iNED?

The qualities required of an effective iNED will vary depending on the needs of the captive board. However, they will likely serve one or both of the following purposes, in addition to bringing valuable independence:

- Bring relevant skills and experience currently missing from the board. If the board chooses not to appoint the insured's risk and insurance manager to the board, it might want to appoint an independent director experienced in risk management and insurance. Alternatively, if the parent-supplied directors cover legal, risk and insurance, but are lacking finance management expertise, it could seek an independent director experienced in this area.
- Offer insight into the sector of the parent company's business. If the captive is owned by a hotel chain, for example, an individual experienced in the hospitality industry may be appealing.

Other characteristics that are important to consider when appointing a new iNED are:

- A proven track record of behaving with integrity and providing independent and sound advice in other board positions or senior roles in business
- The capability to understand and comply with the law
- Relevant professional qualifications
- Confidence, intuition and a proactive nature to challenge assumed wisdom and ask difficult and informed questions
- Finance and technology acumen
- The time capability to carry out their responsibilities diligently and effectively. Boards should consider the prospect's current commitments before confirming an appointment. Candidates should also be conscious of their own time commitments and consider whether they have the capacity to exercise their duties and responsibilities effectively.



“A captive board should collectively have a balance of skills and a broad range of experience; hence, an independent director does not necessarily need to have a risk and insurance background if this skill is already addressed by the board.”

Ann O’Keeffe, Chief Risk Officer, Aon Captive & Insurance Management

The regulator in the local jurisdiction will also have its own 'Fit and Proper' test for assessing nominated directors. This test may consider areas such as the candidate's:

- competency and skills
- ability to devote adequate time to their role and responsibilities
- integrity and reputation
- track record and previous experience with regards to licensed entities
- own financial soundness. For example, have they ever declared bankruptcy?

In light of the OECD's work on Base Erosion and Profit Shifting (BEPS), it is increasingly important that the captive is able to demonstrate control over its own decisions, such as those relating to risk acceptance, claims settlement, investments and selection of service providers.

While the outsourcing of some functions to third parties is acknowledged, the captive must be able to demonstrate that it has competent and relevant decision-makers within the entity itself. Outsourcing risk is viewed as a key risk by regulators in the traditional captive model, and a local iNED who has awareness of the required standard of service is important and something that group directors are unlikely to have.

“Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.”

FRC Corporate Governance Code, 2018

What is the process for iNEDs once appointed?

An iNED, as with any director, will need to register with the local regulator and, in most jurisdictions, will need to be pre-approved before being appointed to the board. Some regulators also require a signed compliance statement when a new appointment to the board is made.

To date, it is common practice for a new director to receive a letter from the captive board confirming their appointment, terms and responsibilities, but these can vary in detail and formality. Best practice should see new directors receive a formal letter, accompanied by a service level agreement or contract, and a company induction pack.

The service level agreement or contract should clearly outline the director's job, their responsibilities and what is expected of them. It should contain

information on the director's term of appointment, remuneration and D&O insurance coverage.

An induction pack should include information on the parent company, its regulated activity, its latest set of financial results and an insurance thematic. A detailed information pack on the captive insurer, its financial health, what its role is and how it supports the insured should also be included.

The captive should consider putting new appointees through director awareness training to reinforce their responsibilities, provide updates on cyber security and GDPR, and outline how to declare conflicts of interests.

A diligent iNED should be expected to request this information if it has not been provided up front.



“A contract, or service level agreement, signed by both parties is beneficial for the captive and the director so that responsibilities and expectations are clearly outlined in advance.”

Julia Graham, CEO, Airmic

How is an iNED's performance measured and can they be removed?

The existence of a service level agreement or contract is essential if a captive is serious about monitoring the performance of its directors. Just as a director cannot be entirely certain of their responsibilities without a formal agreement in place, so the rest of the board cannot hold individual members to account when they fall short if there is no clarity about their role. A contract or service level agreement should outline a fixed term of appointment. As discussed below, if the board follows the UK Corporate Governance Code, this will be a term of three years.

A director may be identified as underperforming if they begin to miss meetings, have clearly not read the materials in advance, are generally underprepared or do not show a clear understanding of the local laws and regulations. They should continue to demonstrate their independence and objectivity in promoting the captive's interests, proving awareness of their arm's-length role.

If it becomes clear that they are not fulfilling their responsibilities sufficiently, the board has a duty to address this. If the other directors do not take action, then they could become liable themselves.

Each year, the board should assess its own performance, with each director reviewing the performance of every other and submitting their feedback to the chair. If it is agreed that a particular director is underperforming, they should then be removed.

The board can choose not to renew the term of a director if it is felt that they are underperforming or if new skills are identified as lacking from the board's composition. For example, it may become clear that actuarial skills are needed and so removing an iNED to make room for a new, more relevant appointment is justified.

In more serious cases, a director could be suspected of misconduct. A misconduct charge could arise from a breach of confidentiality, a GDPR breach or not declaring a conflict of interest. The director could be liable to be sued by the parent organisation or face sanction from the local regulator. If the board does not take action upon finding the misconduct, it could also be liable to action by the parent and/or regulator. In some jurisdictions, regulated boards are required to assess their individual and collective performance annually, so this may become a requirement in more jurisdictions.

“For proposed new iNEDs, captives should provide induction packs, introducing the new director to the captive and the parent company, and offer director training covering an overview of the captive entity.”

Ann O’Keeffe, Chief Risk Officer, Aon Captive & Insurance Management

Term, remuneration and D&O cover

The UK Corporate Governance Code applies a maximum term of nine years, which consists of three terms of three years. Once nine years have been completed by a director, the regulator will usually view the iNED as no longer being independent. If the captive wishes to retain the director beyond nine years, they would need to justify this to the local authority. Alternatively, the captive could appoint an additional iNED, while keeping the established director on the board.

iNEDs are usually remunerated on an annual fee basis. This should be outlined in the service level agreement or contract and be reviewed regularly – every three years is a good benchmark. The captive's shareholders should review director fees and the directors should then be asked to agree to any changes.

For iNEDs, it is important to ensure appropriate directors' and officers' (D&O) insurance has been bought, either by the captive itself or, more commonly, by the corporate group with the policy including coverage for the captive's directors. A certificate of insurance should be provided confirming level of cover, level of the deductible and who covers it, and the name of the D&O insurer. This should be confirmed annually. iNEDs should always ask and ensure, where possible, that they are afforded the same level of D&O cover and protection as other board members.

“The interview process for appointing independent captive directors is more formalised than five years ago. Regulatory scrutiny is higher and there is more scrutiny of applicants as to whether they have the right skill set.”

Kate Storey, Guernsey iNED

“The independence and the knowledge of an outside board director is invaluable to challenge the other directors and captive managers. It should be an essential governance aspect.”

Andrew Bradley, Switzerland iNED

Can more than one iNED serve on a captive board?

Yes. The captive may want to counter 'group think' and increase diversity by ensuring the iNEDs outnumber the parent's representatives and captive manager on the board.

If the shareholder of the captive has a number of directors representing them on the board, it may be important to have more iNED involvement to support and demonstrate independent mind and management for regulatory and tax residence purposes. Guernsey, and some other substance codes, state that a majority of directors should be local if the captive wishes to be a tax resident.

Additionally, the captive's parent may seek to add new specialist skills and experience to the board or broaden its expertise if it has completed a recent acquisition that significantly alters its risk profile.

Captive boards are increasingly utilising 'alternate directors'. These can be used in different ways, but commonly, two directors will alternative their attendance at board meetings while continuing to receive all board papers and minutes. This arrangement can bring greater diversity to the captive board and ensure a healthy pipeline of future directors.

"Captive governance will continue to come under scrutiny as tax authorities maintain a keen interest."

Julia Graham, CEO, Airmic

Five key takeaways for iNEDs

- **Contract.** Demand a contract or service level agreement that clearly outlines your job, responsibilities, term of appointment, remuneration and D&O insurance coverage.
- **Time.** Devote adequate time to read board papers, prepare for board meetings and fulfil your responsibilities.
- **Research.** Build a deep understanding of the captive parent's business, its operations and risk profile.
- **Challenge.** Constructively challenge assumed wisdom and the relationship between the captive and its parent.
- **Value.** Provide independent knowledge and perspective when appropriate to add value to the captive board.

Five key takeaways for captive owners

- **Diversity.** Build a captive board that achieves a range of appropriate skills and demonstrates substance.
- **Onboard.** Put time and effort into the induction of new iNEDs and ensure they are well equipped to contribute effectively. Provide them with a contract or service level agreement.
- **Educate.** Embrace benchmarking and encourage knowledge sharing among your directors.
- **Review.** Monitor the performance and contribution of your directors and whether they are meeting expectations and providing value.
- **Change.** Do not be afraid to alter the composition of your captive board if the captive's profile or needs change.

The background of the page is a blue-tinted photograph of a city skyline at dusk or dawn, with several skyscrapers visible. Overlaid on this image is a pattern of soft, out-of-focus light spots (bokeh) in various shades of blue and white. The text is positioned in the upper left quadrant of the image.

airmic

Marlow House
1a Lloyd's Avenue
London
EC3N 3AA
+44 207 680 3088
enquiries@airmic.com
www.airmic.com