



THE HOW AND WHY OF CAPTIVE POLICY REVIEW

Sara Brundage, of Honigman, reflects on the importance and benefits in reviewing your captive’s policies

Remember those feasibility studies and productive meetings that were instrumental in the formation of your successful captive insurance company or risk retention group? All too often, as those companies now hum along in their operations, the insurance policies developed at formation are simply renewed year to year, and those involved forget that the policies should be reviewed and updated from time to time.

Reviewing insurance policies every few years is not only a prudent best business practice, but it can also save your organisation money by ensuring that the policies clearly reflect what you intend to cover, and equally as important, what you do not. Inevitably, your organisation’s needs change over time; you hire and fire individuals and acquire or divest of affiliates and business lines, and the insurance policy needs be adjusted to fit these new circumstances. The insurance coverage originally put in place now may be too narrow, or too broad, for your organisation’s present situation. A systematic policy review of insurance policies, both vertically through the primary, excess and reinsurance covers, as well as horizontally, across different lines of coverage, is the best way to ensure that your organisation’s coverage continues to keep pace with its needs.

Why is a policy review important?

It is important for organisations to fully understand their coverage to be reassured that it will be in effect as intended when a claim is presented. You also want to make



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sure that the coverage is adequate and up to date based on changes to your organisation, other insurance, and changes in the laws and legislation to ensure that the coverage will adapt with those changes and be there when it is needed.

What events can trigger the need for a policy review?

Case law developments

As commercial and captive policy terms and conditions are disputed, case law can develop that influences the interpretation and application of those policies. For example, recent cases have highlighted the importance of having carefully worded insurance policy language with respect to coverage involving independent contractors, especially closely supervised independent contractors, such as agency nurses. With this development, special consideration now should be given to

defining terms like “employee” to reflect the intent for coverage of contracted and employed individuals, to avoid being in a situation where the captive is required to provide insurance to an individual or entity not contemplated in the premium funding, or not intended to be covered by the named insured.

Other cases have highlighted the importance of being aware of all provisions in policies and reinsurance contracts, even those that are often contained in standard clauses, such as choice of law. For example, a standard choice of law provision may list a jurisdiction with laws that are unfavourable to the insured and impact the potential insurance recovery, among other aspects of the insurance arrangements.

Evolving risks

New and evolving risks often affect standard form policies. Cyber liability and data breach coverage has become more prevalent lately to meet the demands of insureds, giving rise to questions as to whether claims intended to be covered under those policies also could be covered under other policies. For example, recent legal efforts by general liability carriers to bar cyber coverage under their policies may signal a new coverage battle among insureds and carriers as the risk of data breach claims grow. While policyholders may wish to file a claim arising out of a cyber event under all applicable policies, which could include property, crime, professional and general liability, as well as the specific cyber policy, it is prudent for a captive to be aware of how its policy could



be interpreted to provide coverage which may not have been intended, or funded. The same holds true for other commercially issued policies such as directors and officer's liability, employment practices liability and property policies. This highlights the importance not only of coordinating coverage vertically within a tower of coverage, but also horizontally across different lines of coverage. Understanding in particular the "other insurance" provisions of the captive policy and other implicated policies becomes more important to assure that your captive's intent for coverage will be respected when multiple insurance policies are involved.

Claims handling issues

Captive insurance policies most often provide indemnity liability, and require the first named insured to handle, defend, settle and pay claims. That may be a stark difference from commercially issued policies, where the carrier has those obligations. Making sure you have up-to-date insuring agreement language, as well as keeping open communication with insureds and other carriers about the primary responsibility to defend a claim is an important business practice and part of successfully resolving the claim. Policy language also can be critical when drafting claim settlement releases, which should be reviewed carefully to assure that they do not include the release of any rights of recovery that might exist among co-defendants or other insurers pursuant to contractual arrangements between the parties, particularly if

the release provides for any reservation of rights among the parties.

Gaps in coverage

As captive programmes renew, reinsurers may change or add exclusionary language to reflect their own intent for coverage. You should conduct a vertical review of policies to ensure that all policies, starting with the primary, through excess and reinsurance, contain the same terms and conditions so that there is cohesive coverage throughout the insurance tower, or gaps have been identified. For captives, there is a risk that their policy provides coverage broader than their reinsurance, leaving the captive "holding the bag" in situations where that was not intended.

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Coordination between policies and other captive legal documents

In group captives, the captive and its insureds/shareholders typically are parties to shareholders agreement or similar documents that address their respective rights and obligations. Those documents may change over time in ways that affect the policy, and inconsistencies between the policy and other documents are likely to lead to disputes. For example, the time

period for exiting an arrangement spelled out in the shareholders agreement may be different than the time period for cancelling the policy, or the two documents may not be coordinated to make it clear what the rights and obligations are upon termination or cancellation.

What is needed to complete a policy review?

To conduct a policy review, your insurance adviser and legal counsel will need copies of insurance policies and other relevant captive documents; equally as important, however, is an opportunity to discuss your organisation's business practices and intent in providing coverage. For example, does your company have a separate cyber policy such that it wishes to exclude cyber coverage from its captive policy? Do you hire leased employees to work in your facilities under which the leasing agency is required to provide that employee insurance, or is that your responsibility under the contract? Have there been situations where policy language has been misconstrued?

Captive policies are not meant to be a one-size-fits-all product. Instead, they are tailored contracts that need periodic revisions to allow the captive to provide comprehensive, up-to-date coverage for its insureds. Such reviews are integral to running a successful captive insurance company and should be integrated as a best practice by partnering with your insurance advisers and legal counsel to address emerging risks, changes in law and changes to your organisation that may affect coverage. 