A value added

Captives show risk management can be a value centre, rather than a cost centre, say representatives from Steel City Re

Entrepreneurial risk managers are demonstrating through the use of captives how they can be value creators for their parent companies, rather than cost centres.

Captives, by their nature, are designed to provide or acquire insurance coverage that is more closely tailored to their parents' needs or to realise cost savings on coverage. There are also various tax and structural advantages that may apply, of which professionals in the industry are well aware.

However, we are now hearing captive managers talking about other advantages – the opportunity within the organisation to be viewed as more than a procurement department for insurance, for example, and to have their stature within the enterprise recognised and elevated.

Captives enable risk professionals to play a tangible and demonstrable role in enhancing corporate profitability. It also allows them to control management and decision-making with respect to claims – a key function that is often overlooked by corporate leadership, until frustrations arise with outside claims managers.

Perhaps most importantly, it provides captive managers with a simple, clear, and compelling way of demonstrating that an effective risk management process is in place. Simply put, the fewer claims, the stronger the case for effective risk management.

If premiums are reduced and claims are reduced at the same time, captive management will be contributing to the bottom line of the captive transparently, and that is ultimately, but opaquely, reflected in an enhanced bottom line for the parent.

But why stop there? Having produced a results-based case in effective risk management for the board and executive leadership, why not communicate more broadly to external audiences?

Litigation

Increasingly, litigation against corporations is citing reputation damage as a cause of action. Failure by the board to manage reputation risk and protect the company's reputation is mentioned more frequently in securities class actions as well as other types of claims, relating to such factors as product safety or workplace issues.

ESG-linked reputational risk – now often related to aspirational statements about environmental stewardship or social justice – poses perils to every aspect of the organisation, including to individual board members and CEOs who are likely to be on the hot seat when crises occur.

Research by Steel City Re shows that companies with effective reputation risk management governance and operational processes generate a ‘reputation premium’ in the aftermath of crises, with their stock price outperforming their peers. That premium increases dramatically when those risk management processes are transparent to the public.

Stakeholders are less likely to react with hostility when they can see, understand, and buy into the process that was designed to mitigate the damage.

Since reputational value and resilience are based on the degree to which stakeholder expectations and actual performance are aligned, risk management requires marketing input from the outset – as well as leadership from corporate counsel and others. Collaborating with marketing, public relations, investor relations, government affairs, and other public facing departments to communicate about effective risk management, with a demonstrable track record, driven by a captive, is the type of effort most likely to maximise the reputation premium.

The beauty of this external communications programme is that the evidence-based analysis that is necessary is already being done for internal consumption. It merely needs to be repackaged for different audiences.

Of course, captive managers need to develop their strategies and choose their partners carefully. In the current political climate, with corporate America under fire and additional funding about to flow to the Internal Revenue Service, captives are almost certain to become a focus of regulatory scrutiny.

The entrepreneurial mindset must be tempered by prudence. A captive that only receives premiums and never has any claims, for example, could be vulnerable. In the reputation insurance category, we have seen policies written without regard for serious underwriting or analysis of the probability of loss. Underwriting that is actuarially sound, based on voluminous and reliable data, not only provides a defense against litigation, but provides a defense against overly ambitious regulators.

In the hard insurance market that exists today, captives are becoming the best alternative for many companies, particularly those that are the best risks — this is the moment for captive managers to shine. ■

Steel City Re uses parametric reputation insurances, ESG insurances, and risk management advisory services to mitigate the hazards of ESG and reputation risk.

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