



One Vision, Two Disciplines: The Partnership Keys to Captive Success

Image by Carlos Castilla

Ed Goad, chief investment officer at Yousif Capital Management, and Gregory W. Fears, Jr., director and consulting actuary at Pinnacle Actuarial Resources, speak with Captive Insurance Times on the critical importance of aligning actuarial and investment functions within captive programmes

What makes the relationship between the actuary and the investment manager so fundamental to the effective operation of a captive programme?

Gregory W. Fears, Jr: The actuary estimates the timing of claims payments and recommends incurred-but-not-reported (IBNR) reserves. Both directly influence the funds available

for investment and may shape investment strategy. Certain insurance lines of business, such as medical expenses, workers' compensation (WC) payroll, and business interruption, are inflation sensitive. Consequently, sound and coordinated investment strategies can help offset inflationary pressures. For actuaries and investment managers alike, the goal is alignment: ensuring that assets grow as quickly as liabilities.

Ed Goard: A captive exists to pay claims in the future. The actuary estimates how much those claims will cost and when they will be paid, while the investment manager ensures the money is invested in a way that supports those payments. If those two functions are not aligned, the captive risks not having cash when it is needed, earning too little on its capital, or failing to grow surplus efficiently.

What are the potential consequences when the actuarial and investment management functions operate independently of one another?

Fears: When an investment strategy is not coordinated with the underlying liability structure, both sides of the balance sheet can suffer. Liquidity may be constrained, limiting the ability to pay claims and restricting capacity to assume additional risk.

These factors should be carefully considered and integrated into the programme's enterprise risk management (ERM) framework.

Goard: When the two sides do not communicate, problems can develop. The investment portfolio may trigger gains or losses at times that are not optimal for the client, or it might be too conservative and miss opportunities to grow surplus. Either way, the captive becomes less efficient. Regular, structured coordination helps prevent those mismatches before they materialise.

In what ways do actuarial loss projections inform and shape a captive's investment strategy?

Fears: Loss projections influence both the timing and quantity of funds available for investment. Captive insurance companies must ensure funds are available to pay claims and meet collateral obligations. Depending on the lines of business written, limits, premium volume, and claims experience, it could be years before investable funds accumulate to a meaningful level. Ultimately, it is a question of when and how much will be available.

Goard: Loss projections tell us two important things: how much money will likely be needed, and when. If claims are expected soon, we will keep more of the portfolio in stable, liquid investments. If claims are expected further out, we may be able to allocate a portion towards longer-term return. In short, the timing of expected claims drives how the portfolio is structured.

To what extent do investment outcomes feed back into the actuarial process, and how might they influence the broader programme?

Fears: In practice, the feedback loop is limited. Where permissible, longer-term investment returns may be used as the discount rate when discounting loss reserves.

From an ERM perspective, investment income impacts capital, which can in turn increase the programme's risk appetite to write new coverages or increase limits on coverages already written.

Goard: Investment results affect the captive's overall financial strength. Consistent returns help build surplus, which can provide the flexibility to write more coverage or increase limits. Poor or volatile returns can erode that flexibility and weaken capital ratios.

Even though actuarial projections are grounded in claims experience, investment performance plays a meaningful role in the captive's overall capital position.

How would you define asset-liability management in a captive context, and why does it carry particular significance for these programmes?

Fears: There are different theories on asset-liability management (ALM) and how applicable it is for property and casualty (P&C) insurance. While some advocate for asset liability duration matching, which is a risk management strategy designed to minimise interest rate fluctuations, most insurance companies maintain an asset liability duration overhang, meaning the average duration of assets exceeds the average duration of liabilities.

Given the inflation-sensitive nature of P&C claims liabilities, there needs to be a careful balance between ensuring liquidity, maintaining sufficient funds, and earning investment income on premiums until claim payments fall due.

Goard: ALM simply means ensuring that investments are structured by duration, liquidity, and risk to match the captive's expected claim payments. Captives often operate with more limited capital than large commercial insurers, which makes it even more important to balance liquidity, stability, and return. Effective ALM helps ensure claims can be paid without disrupting the broader investment strategy.



The actuary defines the captive's future obligations, and the investment manager ensures the assets are positioned to meet them with strength and stability

Ed Goard
chief investment officer
Yousif Capital Management



Image: Ed Goard, chief investment officer at Yousif Capital Management

How does effective coordination between these two disciplines influence regulatory and rating agency outcomes?

Fears: Coordination between asset and liability risk flows directly into risk-based capital (RBC) calculations. Similarly, for insurance companies pursuing an AM Best rating, the coordination of asset and liability risk is reflected in Best's Capital Adequacy Ratio (BCAR).

In addition, regulators conducting financial examinations will look closely at the interaction between investment performance and underwriting performance.

Goard: Regulators and rating agencies look at both the investments and the reserves. If the portfolio is taking excessive risk relative to the captive's obligations, it can weaken capital measures.

A coordinated approach demonstrates strong governance and thoughtful risk management, which is viewed positively by all stakeholders.

What role does stress testing play in managing the interplay between assets and liabilities, and where does responsibility for it sit?

Fears: Actuaries, investment managers, and regulators all have a role to play in stress testing.

Each participates from their own perspective, placing priority on the quantum of risk within their specific area of expertise, while also considering the interaction between assets and liabilities.

As the level of asset or liability risk increases, the depth and frequency of stress testing would be expected to increase accordingly.

Goard: Stress testing examines 'what if' scenarios. What if markets decline sharply? What if claims come in higher than expected? The investment manager and actuary each test risks in their respective areas, but the most valuable analysis combines both sides, examining, for example, weaker markets occurring at the same time as a claims spike. Responsibility may vary by programme, but it should be a shared effort focused on protecting the captive's financial strength.

What cadence of communication between the actuary and investment manager would you consider best practice?

Fears: The cadence depends on the size and risk appetite of the programme. At a minimum, the parties should communicate annually, most likely in preparation for financial statements or a board meeting. It can also be beneficial for the parties to communicate quarterly, particularly if business conditions are changing or the programme is experiencing rapid growth.

Goard: At a minimum, the two parties should connect annually during financial reporting or board reviews.

For captives that are growing or operating in changing markets, quarterly communication is often more appropriate. Ongoing dialogue helps avoid surprises and allows adjustments to be made before issues develop.

What are the critical data points that should be exchanged between the two parties to ensure alignment?

Fears: Key data that should be exchanged includes the timing of cash flows and payout patterns, interest rate assumptions and investment returns, and measures of volatility related to those two areas.

Goard: From the actuarial side, we need to understand when claims are expected to be paid, how uncertain those estimates are, and any changes in underwriting plans.

From the investment side, we share portfolio liquidity, expected returns, risk levels, and stress-test results. Clear, timely information flowing in both directions leads to better decisions.

If you were to distil the essence of this relationship into a single sentence, what would it be?

Fears: The relationship between the actuary and investment manager is like canoeing. Both are paddling, and only close coordination moves the boat forward.

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