

VERMONT

2015



Manufacturing Risk Management

Cummins utilizes a Six Sigma approach to building a Vermont captive.

Building an Engine For Global Risk Management Success

A fully integrated captive brings risk management to the multiple arms of an organization. BY MATTHEW BRODSKY

What happens when you bring together a master black belt and a green belt to attack an issue? Let's just say that the issue gets resolved in a thorough way.

Such was the case when Cummins Inc. tackled the question of captive insurance in 2008. A green belt led the effort to assess whether captive insurance was right for the Columbus, Ind.-based Fortune 500 corporation that manufactures and distributes engines and power generation machinery. The master black belt came in as reinforcement.

Given that this is a business setting, it is safe to assume we are talking about Six Sigma designations, not karate skill levels.

Judy Ertel, managing director of global risk and the green belt in question, confirmed that Cummins is a Six Sigma organization, a disciple of the tools and techniques of process improvement created at Motorola in 1986 but made famous by Jack Welch at General Electric in the 1990s. And at a Six Sigma organization, a captive insurance assessment would be "very formal," as Ertel attested.

"Six Sigma is very data driven, so we took losses and projected future losses and we looked at it from a

holistic standpoint," Ertel said.

Beyond process improvement jujitsu, what made Cummins' initial captive efforts stand out — and is key to understanding the company's rapid progress — is that this formal, holistic effort was geared at the outset to incorporate "the voice of the customer," as Ertel put it.

To be clear, these are Cummins risk management's internal customers, such as treasury, tax, finance and legal.

That voice of the customer continued to resonate throughout the captive formation process, and continues to be heard now that the captive is fully functioning. It's what's helped to make Cummins' captive an integral component of its global risk management successes — in fact, a core component of its operations around the world, period.

When planning moved closer to execution, the green belt and the master black belt brought in their outside experts — Aon to do a formal captive feasibility study and EY to do accountancy advising — to work with very senior internal people, the CEO and CFO included. Their first step was to consider domiciles. Two offshore and four onshore domiciles were on their



PHOTO COURTESY OF CUMMINS

initial list. This first big decision came down to determining how a captive would best integrate with the company culture and purpose.

"It was very evident at that time that Cummins was very adverse to using offshore domiciles, and it was more of a conservative culture thing. We ended up selecting a domicile based on senior management philosophy, professional expertise and opinions from external vendors, and it turned out to be a really good assessment, a holistic assessment and one that fit with the culture at Cummins," Ertel recalled.

That good fit was Vermont, where in 2010 the Cummins risk management team launched the captive with two lines: global property and U.K. employers' liability. Since, the captive has grown to include nine lines of coverage, with others in the works.

Such growth is a clear indication of strength for broker Peter Kranz,

instance, and Ertel and team are investigating having their exposures placed in the captive. The company faces a business issue in Africa and the captive can help provide "very specific solutions" there as well, Ertel said.

But the captive isn't always the right tool, such as for Cummins' growing business in the Middle East with regional infrastructure projects. There, the captive team did its due diligence and determined that commercial insurance was the better bet.

Again, it all comes down to due diligence and prescience on the part of Ertel and team, who anticipated that a captive would need to be nimble and powerful enough to provide such value to the parent corporation.

FORMAL REVIEW PROCESS

From the get-go, the captive was designed to quickly and effectively consider new business uses. Ertel's team created a formal process in which a business can come to them and ask, "We have this unique business problem or issue. Instead of buying commercial insurance, could we look at you helping us out?"

"Because, again, we are a Six Sigma house," she said, "we have a very formal process where we have to formalize the business case and conduct a feasibility study, and so the framework for putting something in the captive or not has been there since the very beginning, and I think it has permitted us to move very quickly with adding new lines in."

"When you involve the captive and the risk management group and that advisory committee, it gives you a more formal trail that you've conducted your due diligence."

It behooves the business units to understand all risk transfer and

financing options at their disposal.

As part of Cummins' operational evaluations review, business units are evaluated on all components of risk. The cost of traditional insurance is compared to retention through internal funding or by utilizing the captive.

In practice, it can be a matter of a business unit's regional general manager and legal team meeting with the regional risk manager and the U.S.-based captive team to discuss all pros and cons. If the captive is deemed a worthy option, the captive group secures an actuarial study of the risk, which proceeds toward writing the coverage, and terms and conditions, and pricing the premium.

The captive team then takes each request and formally assesses it. The captive has a formal board as mandated by regulation, but Cummins established an internal advisory committee, made up of representatives from across company functions (e.g., treasury, tax, finance and legal). They meet every quarter to address those questions above and request that the business unit document its needs. The captive team asks its own questions in response: "Why is it that you have this exposure? Why is it that you want to transfer it?"

"What is truly innovative about Cummins' captive is how thoroughly integrated it is within Cummins — operations, risk management, tax, legal, and treasury," said Kranz. "Most significant is the connection of the captive to Cummins' global operations through risk management which is interwoven with all operations at Cummins, rather than being siloed off to the side and brought in only when 'something bad happens.'"

Instead, such a process gets out

Summary

- Cummins Inc., a Six Sigma organization, has a formal process to determine the uses of its captive.
- The captive began with two lines and has since grown to nine.
- Operations, risk management, tax, legal, and treasury are all involved in decisions concerning the captive.

ahead of international risk issues. It could be that local regulations require a local fronting partner. Or that local contracts require certificates of insurance showing low-deductible policies, which could conflict with typical multinational coverage programs that are designed for high retentions.

"The captive along with commercial insurance options can be fully assessed and pros and cons of each option made fully transparent for the business to make a local decision," Kranz said.

COLLABORATIVE APPROACH

"Excuse" is not the right word, but the Cummins captive has seemingly become a great reason for the company's risk management team to formalize the discussion of risk — whether that be about property, liability or even benefits. It provides the context, for example, of discussing what sort of financing makes sense for long-term disability benefits in India. The captive



"When you involve the captive and the risk management group and that advisory committee, it gives you a more formal trail that you've conducted your due diligence."

— JUDY ERTEL, MANAGING DIRECTOR OF GLOBAL RISK, CUMMINS INC.

business issue (as well as individual and societal issue) that the captive could assist with.

"Can all of us together

becomes a way, too, for the risk and insurance team within the organization to collaborate with the enterprise risk management team (an otherwise separate entity).

"We will sometimes find an exposure that they are not aware of, or they will find some exposures that we are not aware of, so it is certainly collaborative," Ertel said.

The captive team could even find itself discussing ways to cover an issue such as pandemics. With Cummins projects growing in Africa, disease — as much a terrible burden on the continent as it is a stigma — is on Ertel's radar as another

have that dialogue about solving a business issue? [The captive] engages in a dialogue which makes a multinational corporation a better place to work," Ertel said.

From covering property and employer's liability to tackling population health issues? It shows what a captive can do when integrated into the company in an efficient, structured and analytical way — such as when a green belt and a master black belt get together.

MATTHEW BRODSKY is editor of *Wharton Magazine*. He can be reached at riskletters@irp.com.

A clear view of the risks ahead.

Milliman provides new insights into the risks in today's insurance environment. We are a leading provider of actuarial and management consulting services to captives and risk financing organizations worldwide. We bring depth, clarity, and context to the issues and challenges that our clients face every day.

Milliman has over 60 years of experience and offers consulting services related to enterprise risk management, loss and expense liabilities, risk retention alternatives, pricing and funding, financial modeling, claims management, and underwriting consulting.

 **Milliman**

milliman.com/captives