Strafford Publications Teleconference:

An Overview of Captive Insurance Companies

March 1, 2007

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Organization of Teleconference

I. Overview of Captives

II. Formation and Operation of Captives

III. Role of the Insurance Broker

IV. Third-Party Owned Captives

V. Structuring and Tax Issues

VI. Summary

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I. General Overview of Captives

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I. General Overview of Captives

- A non-public insurance company that writes limited risks
  - Licensed and regulated by a government (state or foreign)
  - Various ownership structures available
  - Various types of captives (single parent, cell, rent-a-captive, group, etc.)
- Flexible and customized tool to respond to changing conditions in commercial insurance markets, the Company's business, and loss history
- Integrated part of the Company's risk management strategy
- Opportunity to insure nontraditional or commercially unavailable coverages
- Provides opportunity to monetize book reserves (e.g., loss portfolio transfers)
- Ensures the Company's management maintains control over utilization and investment of funds (reserves and surplus) in captive
- Variety of exit strategies are available
- Federal and state tax benefits available for properly structured captives

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Business Benefits and Drivers

- Flexibility of captive structure can accommodate changes in the Company's risk tolerance, loss experience, and/or insurance strategy
  - Can change use of captive year-to-year, line-by-line, layer-by-layer, and/or insured-by-insured
- Provides direct access to reinsurance markets
  - Possible additional competition, capacity and pricing benefits
  - Enables stop loss/repackaging of risks within captive to limit its exposure
  - Captive may participate in excess layers or act as conduit to reinsurers
- Centralizes management and accountability
  - May help coordinate programs, definitions and avoid coverage gaps
  - Centralizes administration of risks, reserves, claim analysis and payments
  - Facilitates consolidation of diverse insureds, risks or operating units
- Qualifying captives eligible to participate in
  - Employee benefits captives
  - Terrorism reinsurance (TRIA), subject to Congressional renewal

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Types of Captives

- Single Parent Company-Owned Captives
  - Parent-Subsidiary Captive
  - Brother-Sister Captive
- Group-Owned Captives
  - Industry or Affinity group owners
  - Risk Retention Group
- Third Party-Owned Captives
  - Differing Ownership Group/Entity from business
  - Sponsored Captives
  - Cell Captives
  - Rent-a-Captives
- Employee Benefits Captives
- Warranty Captives
- Other
  - Branch Captives

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Basics about Captives -- Administration

- They are bona fide insurance companies
  - Must be run with due regard for administrative formalities, contracts, arms length pricing, actuarial reserve analyses, funds transfers, claim processing, investment policies, financial statements, etc.
  - Third party captive manager, licensed in domicile, administers captive
  - Broker, other service providers required (actuary, auditor, tax preparer)
- They are licensed and regulated by a domicile (whether a state or offshore)
  - Application for license includes business plan, projected economics, financial statements, investment policy, ownership, identity/bios for officers/directors, etc.; be alert to privacy/confidentiality issues
  - Regulators concerned with protecting insureds (e.g., liquidity/asset matching with projected claims pay-outs, plus cushion), and reputation of domicile
  - Possible registration or premium taxes due in other jurisdictions (depending on risks insured, other factors)
  - Annual statutory filings required with regulators
  - Domicile analysis/selection is important; various factors come into play

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Implementation of Owned Captive—Principal Decisions

- Key Initial Decisions Required to Implement a Captive:
  - What risks are to be initially written by the captive?
  - Where is the captive to be domiciled?
  - How will the captive be owned?
  - Where will the equity capital come from to fund the captive's required equity/surplus—initially, and in the future?
  - What is the projected value of a captive (economic and non-economic)?

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Implementation of Owned Captive—Principal Decisions

- Longer-Term Considerations:
  - What is the strategic plan for the captive?
  - What are some potential uses of the captive in the future?
    - What additional risks could be included (and when or under what conditions)?
    - What coverage gaps or inadequate sublimits exist in commercial programs that captive could address?
    - Might the captive write excess layers on/above particular commercial coverages?
    - Might the captive itself procure basket aggregate/stop loss or reinsurance coverage?
    - What about using the captive to insure/reinsure Employee Benefits?

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Overview of Some Key Business Issues

- What are business objectives and expected benefits from captive?
- What insurance risks are appropriate for the captive?
  - Traditional uses include highly predictable coverages/deductibles (e.g., workers comp, auto liability, general liability, etc.)
  - Nontraditional, customized or volatile risks may also be written
  - Strategic integration with commercial insurance program; systematic, continuing evaluation of potential uses of captive
- When should the agreed risks be written by the captive?
  - Apply a "crawl, walk, run" staged approach or a more accelerated timetable based on business needs or market conditions?
  - Consider inclusion of employee benefits risks? When?
- What are the economic commitments to be considered?
  - Premiums payable by and booked to each insured; computations required on arms-length basis; what is cash availability of each insured?
  - Capital (surplus) contributions required from Owner(s); what is cash availability of Owner(s)—initially and in future?
  - Annual operating costs (captive manager, actuarial certification, audit, statutory filings, tax returns, miscellaneous travel/expenses, etc.)?

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Overview of Some Key Business Issues (cont.)

- Investments of captive?
  - What is captive's investment policy, approach?
  - Financial projections, volatility of insured risks will have impact on security, maturity and solvency issues
  - Tax constraints on loan-backs, and other redeployment options
- Domicile selection?
  - Domestic vs. offshore? Which domicile among relevant choices?
  - Factors include regulatory climate/reputation, infrastructure, risks to be insured, tax consequences, premium tax rates, ownership structure, etc.
- Ownership of captive?
  - Positioning within or outside existing group structure, including estate planning issues and related options, must be considered carefully
- Miscellaneous
  - Potential stop loss/reinsurance by captive?
  - Strategic expansion of captive, timing?
  - Cash/liquidity needs of Owner(s) vs. surplus buildup or pre-funding needs of captive to protect against insured exposures?

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Additional Captive Issues

- Exit Strategies
  - Various alternatives exist to exit captive structure or reduce its scope of activity/coverage/risks (e.g., run-off, LPT, sale, etc.)
- Warranty Captives
  - May be used to consolidate manufacturer's warranties (either embedded and extended), and potentially to obtain tax benefits
  - Entity may not require state licensing/regulation as "insurance company" (while still obtaining Federal income tax benefits if properly structured)
  - May or may not want to reinsure warranty risks into licensed captive
- "Cell" and "Segregated Cell" Captives
  - Concept is to isolate risks/assets of one insured from all others in separate "cells"
  - Usually, the licensed insurance entity is owned by unrelated party
  - Recent IRS published rulings and Notice 2005-49 may cast doubt on tax effects of some structures
  - Significant governance, economic, cost, and entry/exit issues may exist

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Overview of Key Group/Cell Captive Issues

- Governance
  - Who controls decisions for the entity (e.g., admission of new insureds, writing additional risks; investment decisions; voluntary and involuntary exit procedures; wind-up/liquidation decision; appointments of advisors, auditor, actuary, manager, etc.)? What's in the "shareholders" agreement?
- Financial Solvency
  - Who verifies adequacy of entity's assets to pay all risks and policy limits? Who implements stop loss coverage or other protection? How are "capital" contributions of insureds treated for book/tax purposes? If a cell structure, how are claims treated that exceed each cell's assets? Tax issues?
- Account Shortfall
  - If insured's assets/premiums inadequate to pay its losses, is insured obliged to contribute the shortfall? When? What if the insured non-renews?
- Termination
  - How does one end the relationship? Timing/process? Does ex-member get back its capital? Net reserve account balance? When? How is refund or return treated for book/tax purposes?
- Domicile/Domestication
  - Is entity onshore or offshore? If offshore, who decides if it will make 953(d) election and pay US tax (while avoiding excise tax on premiums)?

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II. Formation and Operation of Captives

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WHERE ARE CAPTIVES FORMED?

Domicile#	2000*	2005^	Variance
Bermuda	1,405	987	(418)
Cayman Islands	535	733	198
Vermont	381	542	161
British Virgin Islands	184	383	199
Barbados	237	301	64
Ireland	178	207	29
Hawaii	73	158	85
South Carolina	2	122	120
Nevada	2	58	56

active licenses * per A.M. Best ^ per Business Insurance

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DOMICILE SELECTION CONSIDERATION

- Domicile reputation and political stability
- Domicile regulatory and service provider infrastructure
- Domicile industry expertise
- Type of risk insured
- Tax and accounting
- Cost of operation (taxes, fees, other)
- Location and ease of access
- Relationship of your service providers to the regulators

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WHY GO OFFSHORE

- Ability to write third party business and unusual insurance coverages
- Lesser regulated environment
- Lower capital/surplus requirements possible
- Greater investment flexibility
- Possible tax benefits (i.e., no premium tax, possible income tax benefits/exemption)
- No ownership restrictions
- Exotic locations

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WHY NOT OFFSHORE

- Inability to write insurance coverages regulated by the Federal Government (i.e., ERISA employee benefits)
- Inability to access Federal Government programs (i.e., Terrorism Risk Insurance Act of 2002)
- Possible tax restrictions/disadvantages (dual consolidation loss rule, Federal Excise Tax, RPII, branch profit tax)
- Higher cost of operation
- Accessibility and ease of operation
- Reputation (tax havens)

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CAPTIVE PROJECT OVERVIEW

- Analysis of current insurance program
- Pre-feasibility study (goal identification and service partner selection)
- Initial testing of reinsurance and fronting markets
- Feasibility study (actuarial/accounting/tax review)
- Domicile analysis
- Go / No Go decision
- Corporate risk management adjustments/responsibilities
- Captive application, formation and approval
- Captive begins insurance operation

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CAPTIVE FEASIBILITY STUDY

- How much should it cost and how long should it take?
- Varies based on
  - pre-defined scope, comprehensiveness and complexity
  - number of insurance lines to be insured, parties involved, quality and accessibility of loss and financial information, etc…
- Cost: $30,000 to $50,000 plus
- Timing: 6 weeks to 6 months plus

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FEASIBILITY – WHAT DOES THIS REALLY MEAN?

ACTUARIAL STUDY

- Data collection
  - 3-5 years of detailed loss information
  - Exposure information
  - Historical loss patterns
  - Frequency and severity analysis
  - Schedule of large losses
- Projections
  - Premium determination
  - Occurrence / Aggregate stop loss retention evaluation
  - Confidence level analysis
  - Capitalization Requirements

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FEASIBILITY – WHAT DOES THIS REALLY MEAN?

FINANCIAL & OPERATIONS STUDY

- Data collection
  - Organizational chart
  - Industry and regulatory information
  - Most recent available financial reports
  - Accounting and tax methodology
  - Schedule of insured and retained risks
- Projections
  - Pro forma financial statements
  - Net present value cash flow benefit analysis (tax benefits)
  - Consolidated EBITDA effects
  - Schedule of operation and other non-financial benefits and shortcomings

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CAPTIVE IMPLEMENTATION / FORMATION STEPS

1. Service Provider Selection
2. Organization Documents Preparation
3. Captive Name Selection and Registration
4. Incorporation
5. Organizational Meeting and Opening of Bank Accounts
6. Captive Business Plan Preparation
7. Captive Pro Forma Financial Statement Preparation
8. Meeting with Captive Domicile Regulators
9. Captive Application Package Filing
10. Capitalization
11. Application Review and Licensing
12. State registration and other licensing requirements, as applicable
13. Establish and hold initial Board of Directors meeting
14. Begin Operations!

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Service Provider Selection-Role-Obligations

REQUIRED PROVIDERS (may vary by domicile)

- Captive Manager - accounting, regulatory and management oversight
- Actuary - annual loss certification
- Financial Auditor - annual audit opinion (and possibly tax filings)
- Bank - statutory capitalization and operating funds

ADDITIONAL PROVIDERS

- Attorney - corporate secretary and legal/tax advice
- (Re)Insurance Broker / Intermediary - reinsurance placement
- Third Party Administrator (TPA) - claims administration
- Investment Manager / Advisor - investment advisory
- Consultants - risk management and tax advice

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CAPTIVE BUSINESS PLAN & PRO FORMA

BUSINESS PLAN

- Captive type / proposed ownership / capitalization
- Risk insured / lines of business (including limits)
- Proposed program structure (i.e. fronted, direct, reinsurance)
- Rating methodology / loss control program description
- Service providers compensation / proposed Directors and Officers
- Actuarial & Financial projections overview

FINANCIAL PROFORMA

- 5 year projection under both an “Expected” & “Adverse” scenario
- Basic financial reports and Appropriate Notes
- Consistent with the actuarial projections
- Conservative investment returns and inflation factors

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CAPTIVE APPLICATION FILING

A COMPLETE CAPTIVE APPLICATION WILL INCLUDE THE FOLLOWING:

- Domicile application form signed by a director of the captive
- Incorporation documents
- Biographical Affidavit for directors & officers
- Captive Feasibility Study, Business Plan and Financial Pro Forma
- Listing of service providers with description of fee arrangement
- Parent company audited financial statements
- Insurance policy(ies) and other material agreements
- Applicable filing fees

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APPLICATION REVIEW & LICENSING

- Most domiciles require at least two copies of the application binder
- Normally takes between 30 to 60 days
- Applications are sometimes reviewed internally by the domicile regulators or by outside consultants
- Application fees will normally range between $3,000 - $10,000
- Some domiciles will issue conditional licenses
- Upon receipt of its license, the captive is only authorized to do business in its location of domicile

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Domicile Laws & Regulations Summary

- Business Plan Amendments (prior-approval)
- Annual Filing Requirements ^
  - Annual Statutory Reporting (February 28th) *
    - Actuarial Certification (June 30th) *
    - Audited Financial Statements (June 30th)
  - Annual Premium Tax Return (February 28th) *
  - Annual License Fee
  - Parent Company Financial Statements *
  - Updated Biographical Affidavits (within 30 days of change to Board of Directors and/or Officers) *
  - Tax Return Filings *

^ Assumes a December 31st year end
* May not be required in some domiciles

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Service Provider – Ongoing Operation Costs

SERVICE PROVIDER	LOW END (US $)	HIGH END (US $)
Captive Manager	$25,000	$150,000
Actuary	$7,500	$50,000
Auditor	$12,000	$50,000
Bank (letter of Credit)	25 basis points	50 basis points
Investment Management	30 basis points	50 basis points
Attorney	$250 per hour	$500 per hour
TPA	Per claim charge, varies based on risk insured	
Consultants	Project specific	

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SUCCESSFUL CAPTIVE ATTRIBUTES

- Good loss experience and loss control program
- Spread of risk with predictable losses
- Fronting and reinsurance support, as required
- Financially stable parent(s)
- Good non-tax business purpose
- Long term commitment from management
- Strong business partners
- Positive financial return to corporate family
- Continuous re-evaluation of business purpose and growth opportunities

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III. The Role of the Insurance Broker in Captives

and

IV. Third-Party Owned Captives

Presented by:

Geoffrey T. Smith

TD Banknorth Insurance Agency

March 1, 2007

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The Cost of Risk:
Where the Insurance Dollar Goes . . .

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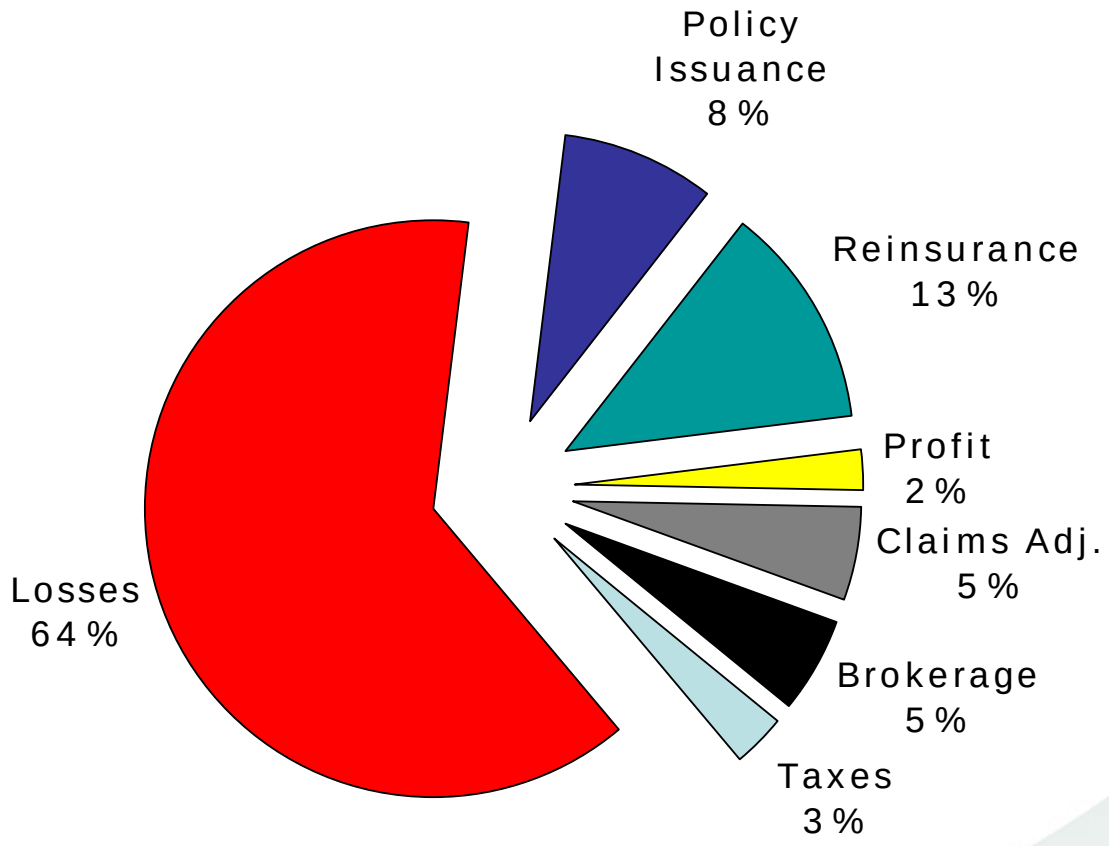

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Why the risk manager considers alternatives . . .

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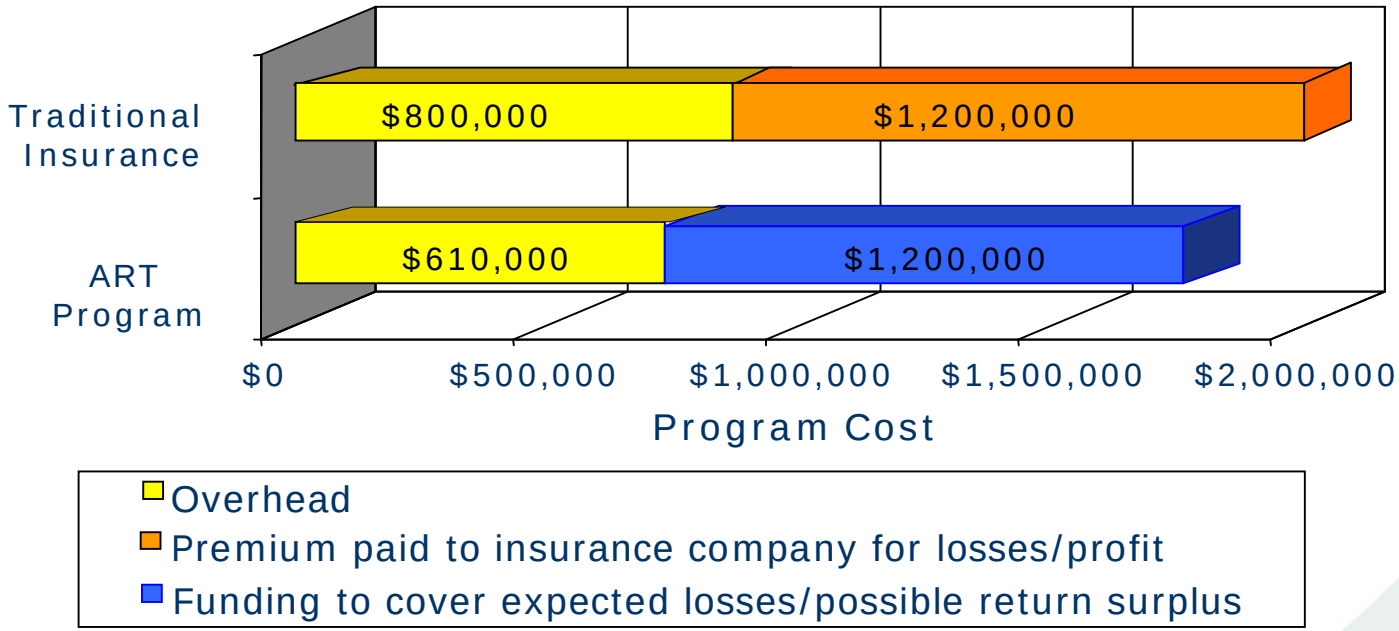
If expected losses are $1.2 million. . .



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Alternative Funding Approaches: Pros and Cons

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	Pros	*Cons*
Insurance	1. Proven reliable 2. Established procedure	1. Expensive 2. May require litigation 3. Insurer controls everything
Large Deductible Plans	1. Funds stay in business 2. Manage as accrual	1. No tax acceleration 2. Collateral required 3. "Silos" 4. Pressure to underfund
Self-Insurance	1. Lower collateralization 2. Control over claims 3. Comparatively low costs	1. High administrative burden 2. State specific
Captives	1. Multi-line 2. Multi-state 3. Tax acceleration (?)	1. Collateral required 2. Losses must be pre-funded 3. Cannot be a short-term solution

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Policy Issues: Policy Language

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- Fronted Programs
  - Insurer usually dictates
  - May be expanded where underwriting capacity is created.

- Direct Placement
  - Highly customized
  - Who reinsures?
  - Who handles claims?
  - Are claimants third party or first?
  - Issues of acceptability

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Policy Issues:
Gap Protection

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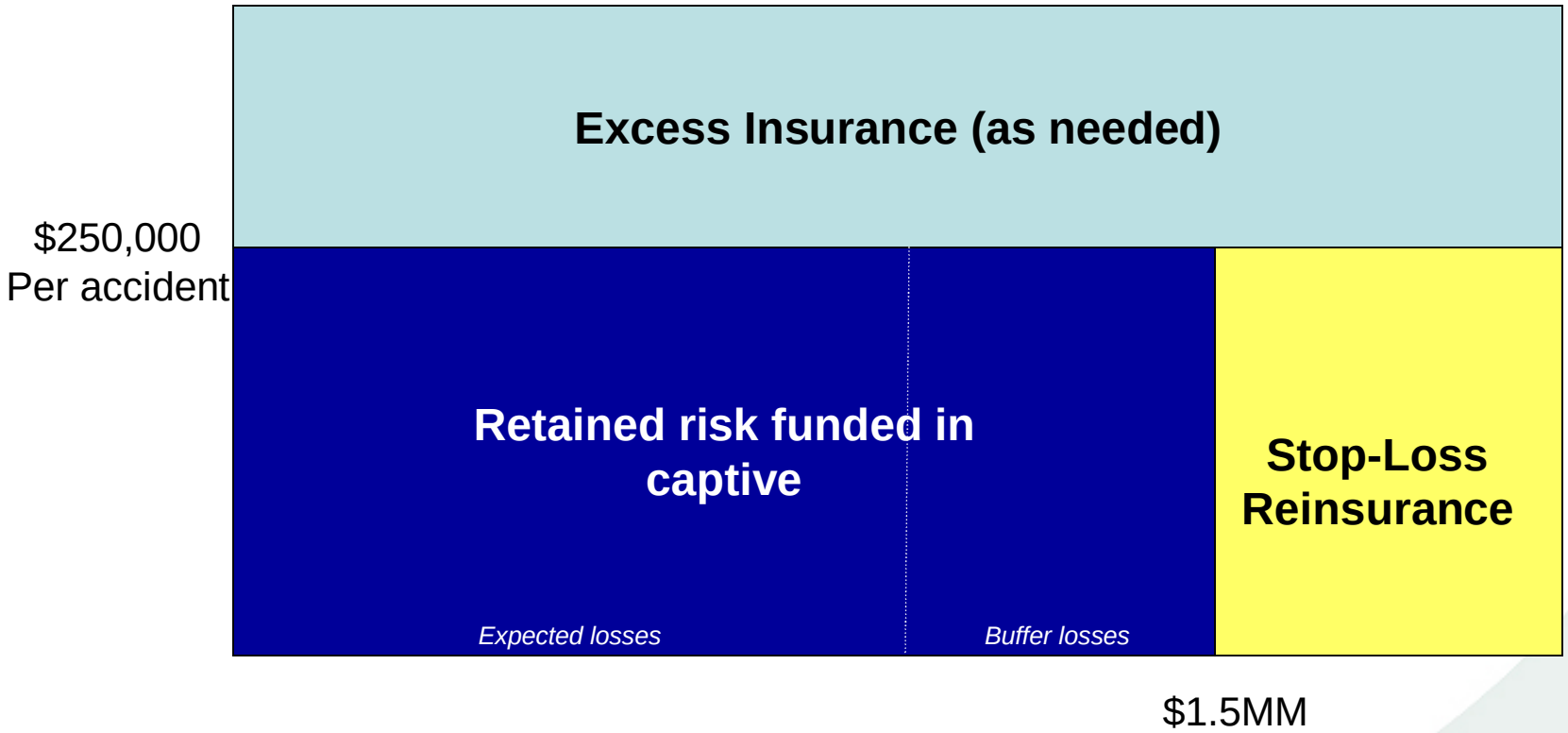

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Policy Issues: Differing Risks

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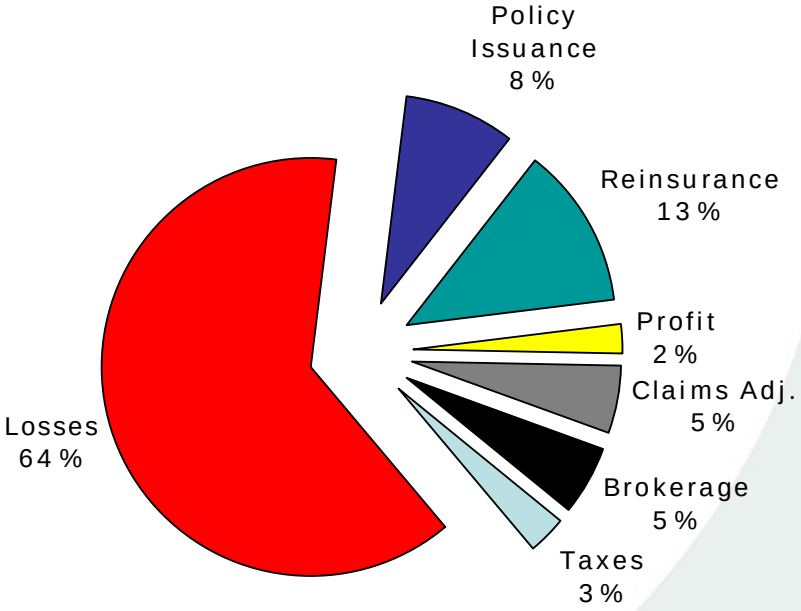
- What risks are ideal for a captive?
  - Predictable
  - Low severity / high frequency
  - Long-tail (improved cash-flow)
- What are the most common risks insured?
  - Workers Compensation (fronted only)
  - Auto and General Liability
  - Property
  - Warranty
  - Professional liability



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Market Cycles Affect Captive Formation

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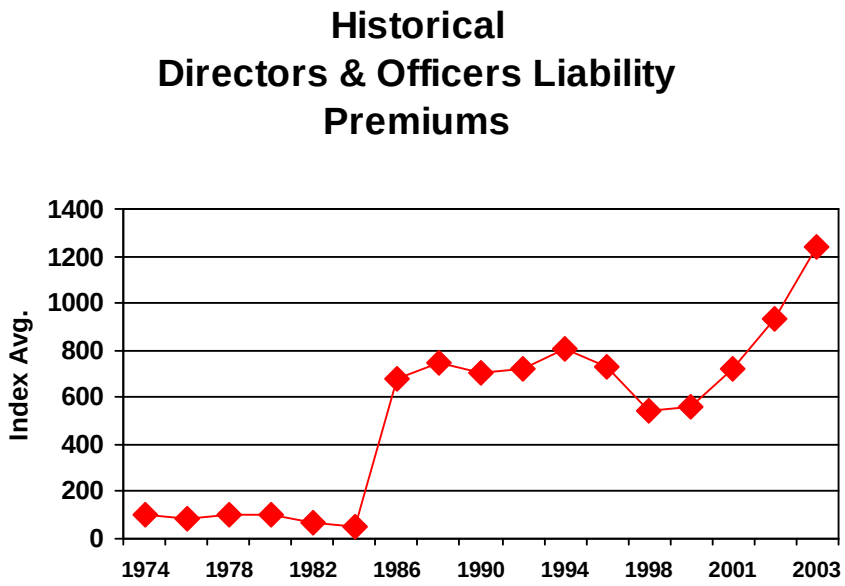

- Insurance pricing moves in cycles
  - Catastrophic circumstances
  - Litigation environment
  - Investment environment
  - Changes in competitive environment
- 2006 was a very profitable year for insurers
  - No hurricanes
  - Good stock market
  - Strong rate structure
- 2007 will be a good year for insurance buyers in *many* classes.

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Types of Captives

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Type of Captive	Pros	Cons
Pure or Single Parent	+ Control all decisions	– Absorb 100% of costs
Association or Group	+ Share costs + Gain economies of scale + Create capacity	– Share control – Joint & several liability
Rent-a-Captive	+ Lower costs	– Least amount of control – Joint & several liability
Agency Captive	+ Lower costs	– No control – Very risky, primary benefit to agency

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What is a Risk Retention Group (RRG)?

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- Established by Congress in 1981
- A special-purpose insurance company
  - Licensed in one state, can issue policies in all states
  - Limited to liability insurance *only*
  - Subjected to full insurance regulation and compliance requirements
  - Policyholders must be owners, and vice-versa
- Can issue policies directly (save fronting costs)

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Steps to Forming a Captive

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Pre-Feasibility → **Feasibility** → **Design** → **Implementation**

Pre-Feasibility

- Conceptual review
- Funding appetite
- Commitment to alternative market solution
- Parameters of program (lines of coverage, limits, etc)

Feasibility

- Define objectives
- Project loss costs
- Estimate non-loss costs & premiums
- NPV comparison of alternatives
- Develop program structure
- Determine ownership structure
- Analyze tax issues

Design

- Business plan development
- Financial pro formas
- Domicile comparison and selection
- Identification of service providers including fronting insurers and reinsurers

Implementation

- Development and filing of captive application
- Captive formation & capitalization
- Service provider selection
- Fronting and reinsurance placement
- Creation of governance structure

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Data Development – What's typically needed

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- A "back of the envelope" evaluation
  - 5-7 years' losses, exposures, premiums, program structures, W.C. experience mod (if applicable)
  - Latest full year's financial statements
  - Confidentiality Agreement
- The Analysis Report
  - Full insurance application information
  - Establishes business objectives
  - Actuaries determine program costs and retention levels
  - Legal issues of domicile, ownership, licensing and tax are defined
  - Fronting and reinsurance costs are scoped out
- Implementation

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Sponsor / Owner Responsibilities

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- Regulatory compliance
  - Capitalization
  - Licensing
  - Contractual obligations
- Insurance program structure
  - Fronting and reinsurance partners
  - Claims management
  - Loss control management
- Assessment / dividend policy
- Investment policy

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The "Back Room" – A Captive's Business Partners

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	Single Parent	Rent-a-Captive	Group / Association
Insurance Broker	x	x	X
Captive Manager	X	x	x
Actuary	X	x	
Auditor	X		
Legal Counsel	X	X	X
Investment Mgr.	X	X	
Regulators	X		
Captive Board	X		X

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V. Structuring and Tax Issues

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V. Structuring and Tax Issues Relating to Captives

- Federal tax issues
  - Must be an "insurance company" under Internal Revenue Code to obtain favorable tax treatment
    - "More than half" of its business annually must be "insurance"
  - US captive included in consolidated tax return; tax accounting losses of captive may offset other taxable income of consolidated tax group
  - Offshore captives owned by US Shareholders create additional US tax liabilities and exposures (e.g., Federal excise taxes on premium payments by US insureds to foreign insurers/reinsurers, Subpart F rules regarding deemed income)
    - Captive may elect to be taxed as "domestic" company; alleviates some, not all, tax disparities
    - Foreign captives generally not subject to income or premium taxes
- State tax issues
  - State-licensed captive generally exempt from that state's income tax (investment earnings and underwriting profits not subject to state tax)
  - Will likely pay "in lieu of" state premium tax (e.g., on first $20 MM of premium: 0.38% in VT, 0.2% in DE, 0.25% in HI)

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Basic Tax Issues Relating to Captives

- Recent I.R.S. Rulings and Structuring Considerations
  - Three Revenue Rulings in late 2002 established general principles to determine tax qualification of certain captive insurance companies
    - IRS Rulings control interpretation and audit results by IRS agents
    - Rulings addressed 25 years of interpretative disputes with taxpayers
  - The 2002 Rulings covered three types of captives:
    - Parent/Subsidiary Captives (captive insures risks of its parent and, perhaps, unrelated risks)
    - Brother/Sister Captives (captive insures risks of its commonly-owned brother/sister affiliated companies, not its parent)
    - Group Captives (captive insures specific, common risk(s) of a group of unrelated owners)
  - IRS recently issued (June, 2005) a new Notice and a Revenue Ruling:
    - The Notice: requested comments by professionals whether "a cell captive arrangement constitutes insurance," and about "finite risk"
    - The Revenue Ruling: determined under various fact patterns that having only a single "policyholder" or insured failed to establish the requisite risk shifting and risk distribution for tax purposes.

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Basic Tax Issues Relating to Captives (cont.)

- Recent I.R.S. Rulings and Structuring Considerations (cont.)
  - Key common principles established in 2002 by the IRS for captive structures to qualify for Federal tax benefits:
    - All premiums must be pooled by the captive
    - All assets (premiums, reserves, surplus) must be available to pay all risks being insured
    - Captive cannot loan funds to its parent, owner(s) or insureds
    - No parent or insured can guarantee the captive's performance
  - Additional requirements for qualification as an "insurance company:"
    - Adequate risk shifting and risk distribution must be present
    - Captive must still meet business purpose, administrative/regulatory requirements, arms-length pricing, proper documentation, etc.
  - Where parent companies seek to insure their risks with their wholly-owned captive:
    - "More than half" of captive's risks must be "third party" risks, or the captive does not qualify as an "insurance company" for Federal tax purposes, according to IRS

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Basic Tax Issues Relating to Captives (cont.)

- Recent I.R.S. Rulings and Structuring Considerations (cont.)
  - Single Policyholder/Insured—Revenue Ruling 2005-40
    - Insurer was "unrelated insurance company"
    - Risks covered related to the Insured's fleet of courier vehicles
    - No guarantees "of any kind" and no loan-backs to Insured
    - Four Situations addressed:
      - Situation 1: a single Insured (policyholder) of unrelated insurer
      - Situation 2: two Insureds (90% and 10%) comprised total risks
      - Situation 3, 4: 12 single-member, disregarded LLCs as Insureds (Sit. 3) or treated as separate "corporations" (Sit. 4); all commonly owned
    - Holding: "single policyholder" (even with unrelated insurer) lacks risk distribution, hence does not qualify as "insurance":
      - Situation 1: single Insured, no distribution of risks
      - Situation 2: 10% add'l risk insufficient (citing RR 2002-89, Sit. 2)
      - Situation 3: disregarded LLCs treated as single Insured (parent)
      - Situation 4: 12 LLCs treated as separate corporations/Insureds resulted in adequate risk distribution (citing RR 2002-90)

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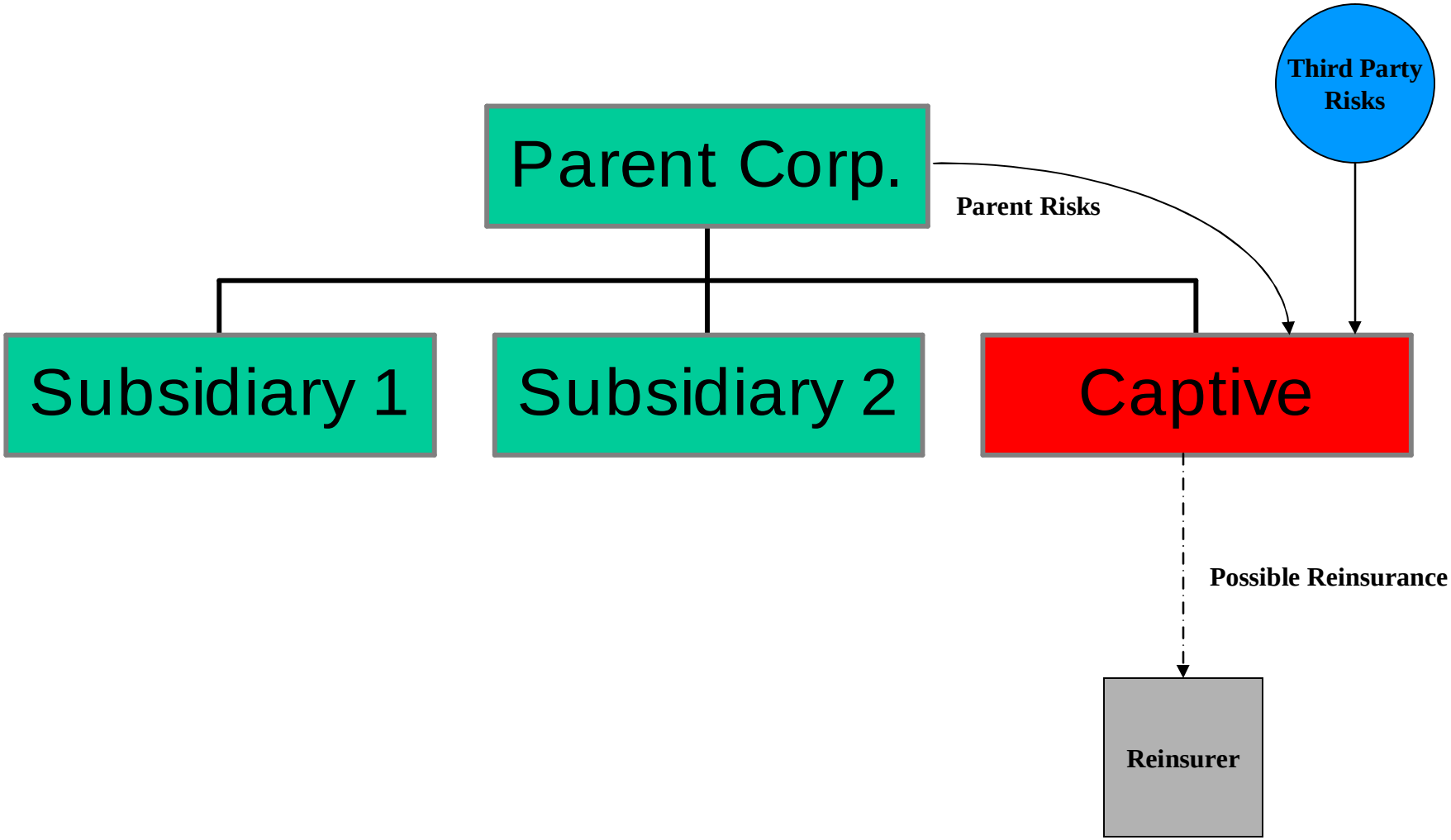
Example of Parent/Subsidiary Captive Structure



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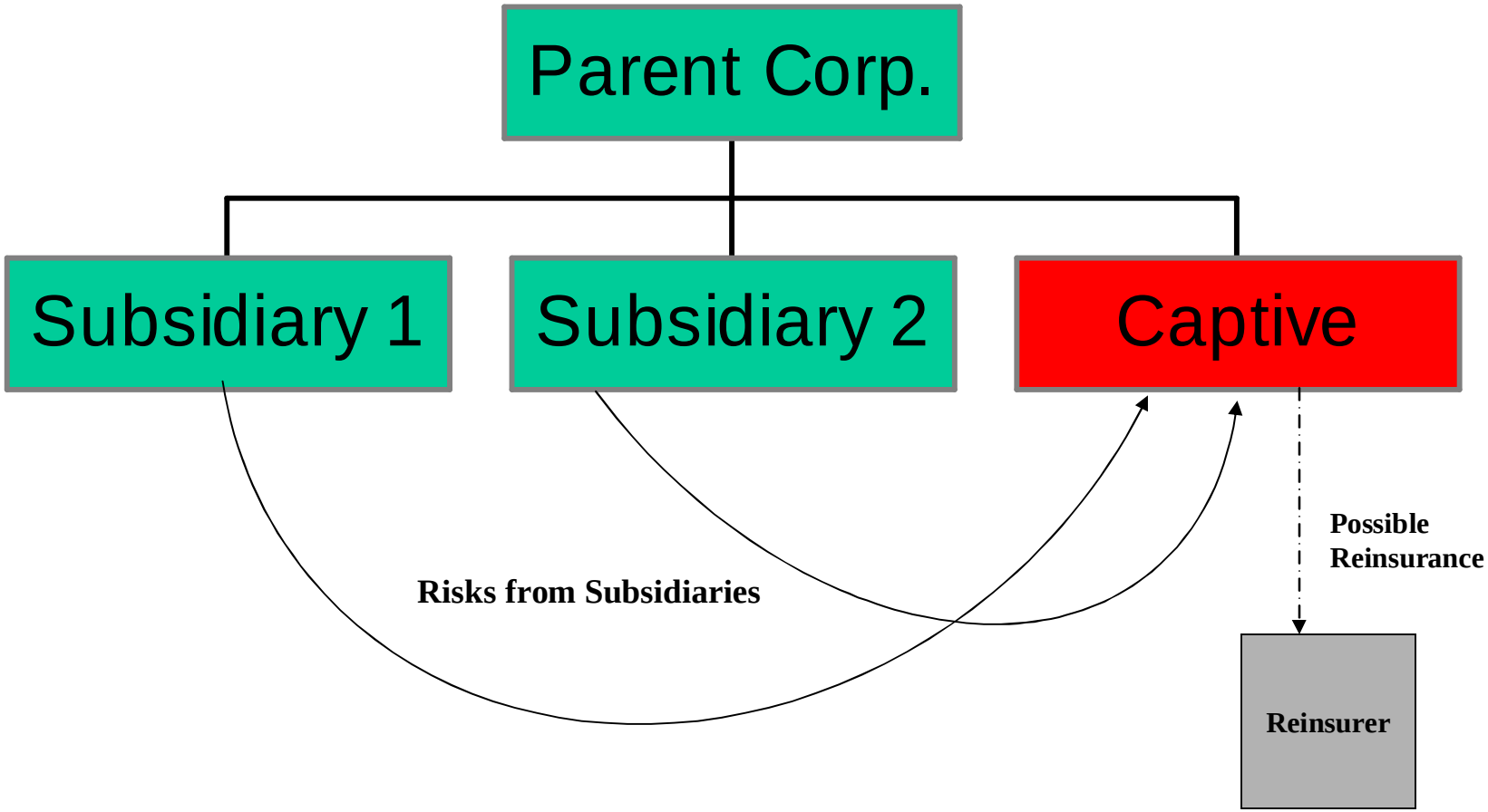
Example of Brother/Sister Captive Structure



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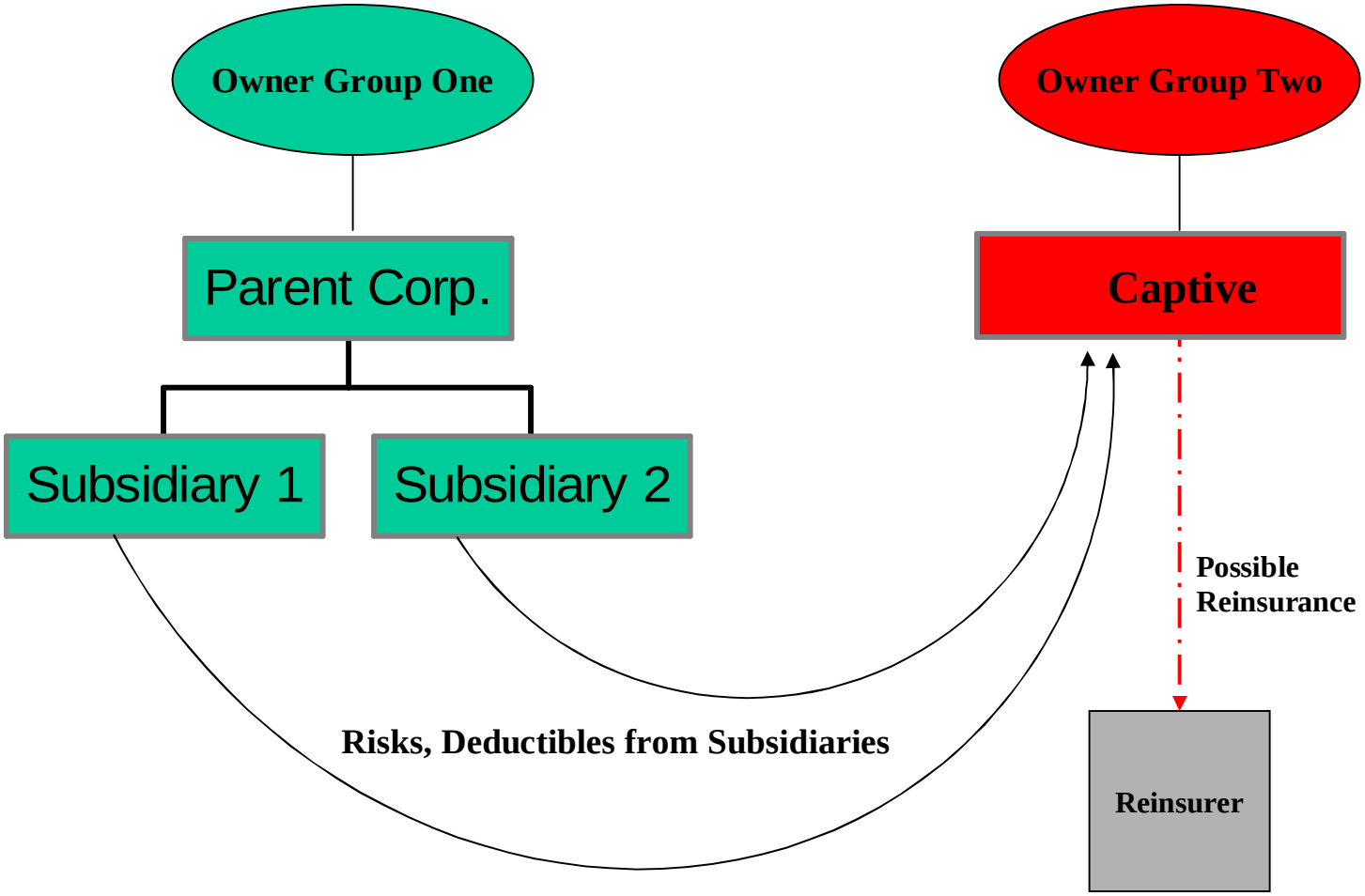
Example of Alternative Captive Structure -- 1



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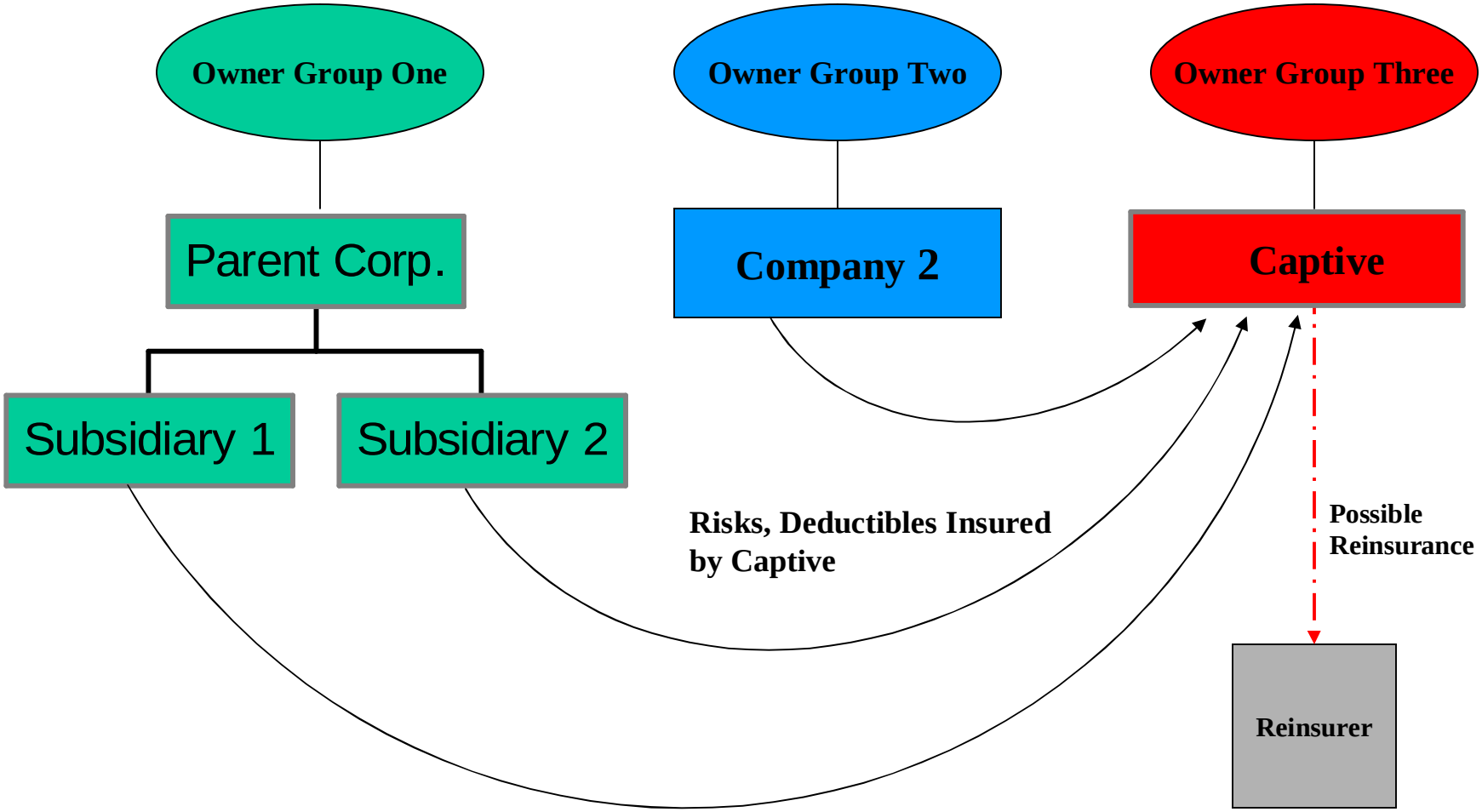
Example of Alternative Captive Structure -- 2



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Some Tax Factors in Domicile Selection

- Domestic
  - If parent-owned captive, should be included in group's consolidated financial statements (subject to confirmation by auditors)
  - If parent-owned captive, should be included in group's consolidated Federal tax return
    - State filings vary based on various "unitary" and "separate" reporting statutes
  - Generally, not subject to state income tax (on captive's income, profits, investments, etc.)
  - Generally, is subject to lower "in lieu of" state premium taxes
    - Depending upon domicile, may be able to secure lower rates (or exemption) on LPTs, etc.
  - If company were to consider in future using captive for employee benefits risks, or terrorism coverage (if reenacted by Congress), must have a "domestic" captive
  - Licensing fees, captive management/audit fees, etc., generally similar to offshore domiciles

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Some Tax Factors in Domicile Selection (cont.)

- Offshore
  - Incorporated entity, formally licensed/regulated by foreign government regulators
  - If parent-owned company, may be included in group's consolidated financial statements (subject to confirmation by auditors)
  - Generally, parent-owned foreign captive NOT included in group's consolidated tax return
    - Captive may make tax "domestication" election and be includable in consolidated return, but limits still exist on using tax losses against group's income
  - Generally, not subject to foreign country income taxes or to foreign country premium taxes
  - Subject to US Federal excise tax on premium payments to offshore insurer/reinsurer (4% or 1%, respectively), unless make "domestication" election for tax purposes
  - May be a perceived "taint" currently with incorporating/reporting owned offshore entity

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Summary Comparison of Vermont vs. Hawaii

VERMONT	HAWAII
Licensed Captives: Approx. 524 (all kinds)	Licensed Captives: Approx. [175?] (all kinds)
Premium taxes: • < $20 MM: 0.40 % • $20-40 MM: 0.30% • $40-60 MM: 0.20% • > $60 MM: 0.075%	Premium taxes: • < $25 MM: 0.25 % • $25-50 MM: 0.15% • > $50 MM: 0.05%
Captive Fees: Application: [$200] Application Actuarial Review: TBD (~$3500?) Annual License: $ 300	Captive Fees: Application: $1000 Application Actuarial Review: TBD (~$3500-7000?) Annual License: $ 300
Statutory Capital: $250,000 (minimum) (part of agreed surplus)	Statutory Capital: $250,000 (minimum) (part of agreed surplus)
Administrative Matters: Office/records in VT, VT-licensed manager, resident agent; one annual meeting of Directors in VT; audited financial statement/actuarial certification annually	Administrative Matters: Office/records in HI, HI-licensed manager, resident agent; one annual meeting of Directors in HI; audited financial statement/actuarial certification annually
Company's Business Connection: ?	Company's Business Connection: ?

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Additional Tax-Related Captive Issues

- Employee Benefits Captives
  - May insure/reinsure employee benefits (e.g., LTD, life, AD&D, etc.)
  - Return income, underwriting profits, and tax-advantaged investment earnings to corporate balance sheet
    - Adverse loss exposure mitigated by role of commercial fronting insurer
  - Qualification and benefits involve overlap with ERISA/DOL requirements (e.g., "prohibited transaction" rules)
    - To date, approximately 10 exemptions granted by DOL
    - Detailed submission/documentation required
  - Other cultural factors, employee communications, role/approval of unions, etc., vary by company
  - Must meet all Federal income tax requirements as well
  - Assets of benefits captives remain in, and invested by, captive
    - Generally, not available to operations
    - Fronting insurer may impose additional investment restrictions

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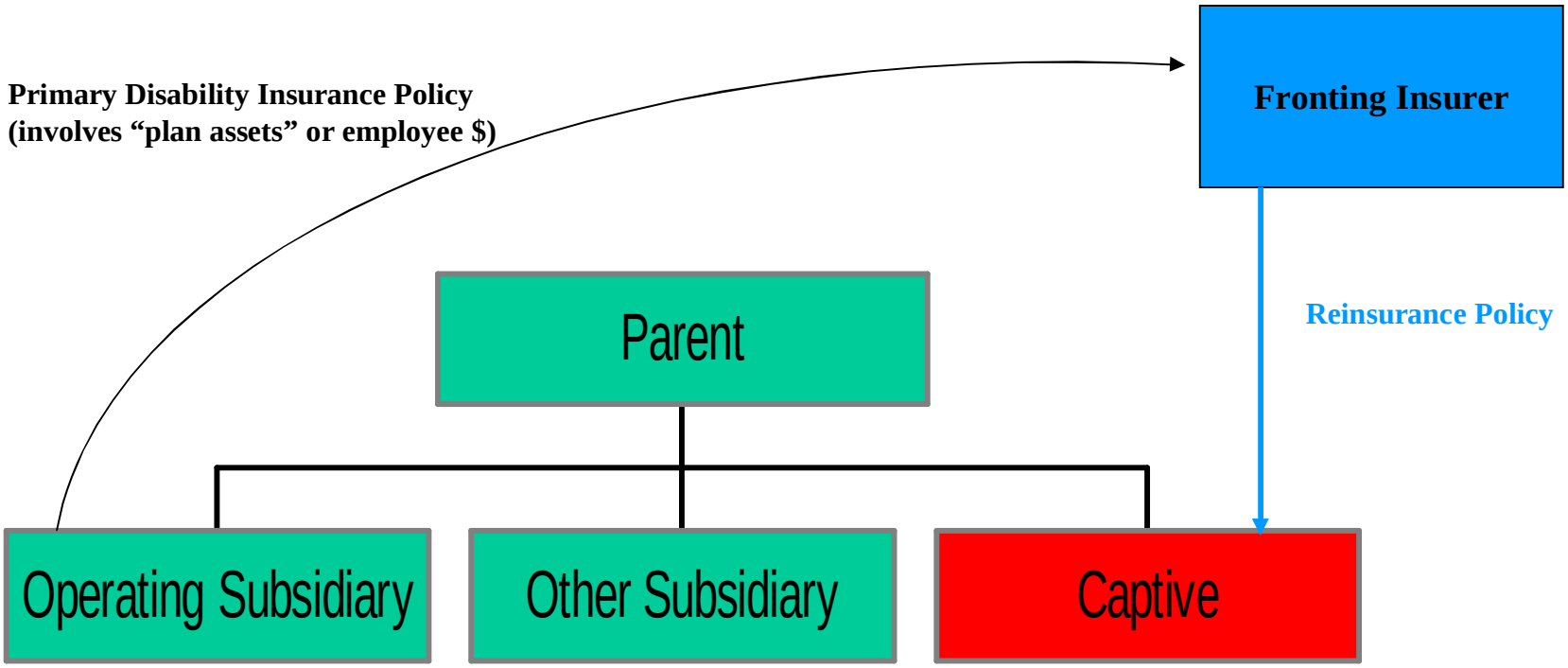
Example of Employee Benefits Captive Structure



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VI. Summary of Captives

- Bona fide insurance company, registered and regulated by governmental agencies
- A sophisticated, flexible and customized "tool" to be used as an integrated part of company's overall risk management strategy
- Enables company to adapt to changing commercial market conditions, as well as its own changing business needs
- Can access reinsurance markets directly, and thereby offer increased capacity, pricing and competition benefits
- Owned by same parent entity or ownership interests as other businesses; company management retains control over the business/assets of captive (subject to regulatory requirements)
- Properly structured and administered, captive can achieve Federal and state tax benefits
- Various exit strategies are available from captive's business or structure
- Feasibility analysis, assessment of ownership alternatives, and adherence to "crawl, walk, run" approach may be appropriate, especially for initial establishment and operation of captive
- Companies will depend upon captive manager (and third-party owner, if appropriate) for proper administration, regulatory guidance and "know who"

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