

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- **Today's Moderator:** Richard F. Klumpp
- **Actuary:** Brian Johnson
- **Captive Manger:** John R. Capasso
- **Underwriter:** Sandra L. Fenters
- **Estate Planning Attorney:** Trisha W. Hall
- **CPA:** Joanne Kenney Shaver

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid

Part I: Underwriting & Business Plan Development

Control Continuum: The “Who”

Less Control

Greater Control



First
Dollar
Program

Safety
Dividend
Program

Large
Deductible
Retro-Plan

Protected
Self Insurance
(Aggregate
Protection)

Specific
Excess
Insurance
No Aggregate

Rent – A –
Captive

Captive
Or RRG

Pure
Self Insurance

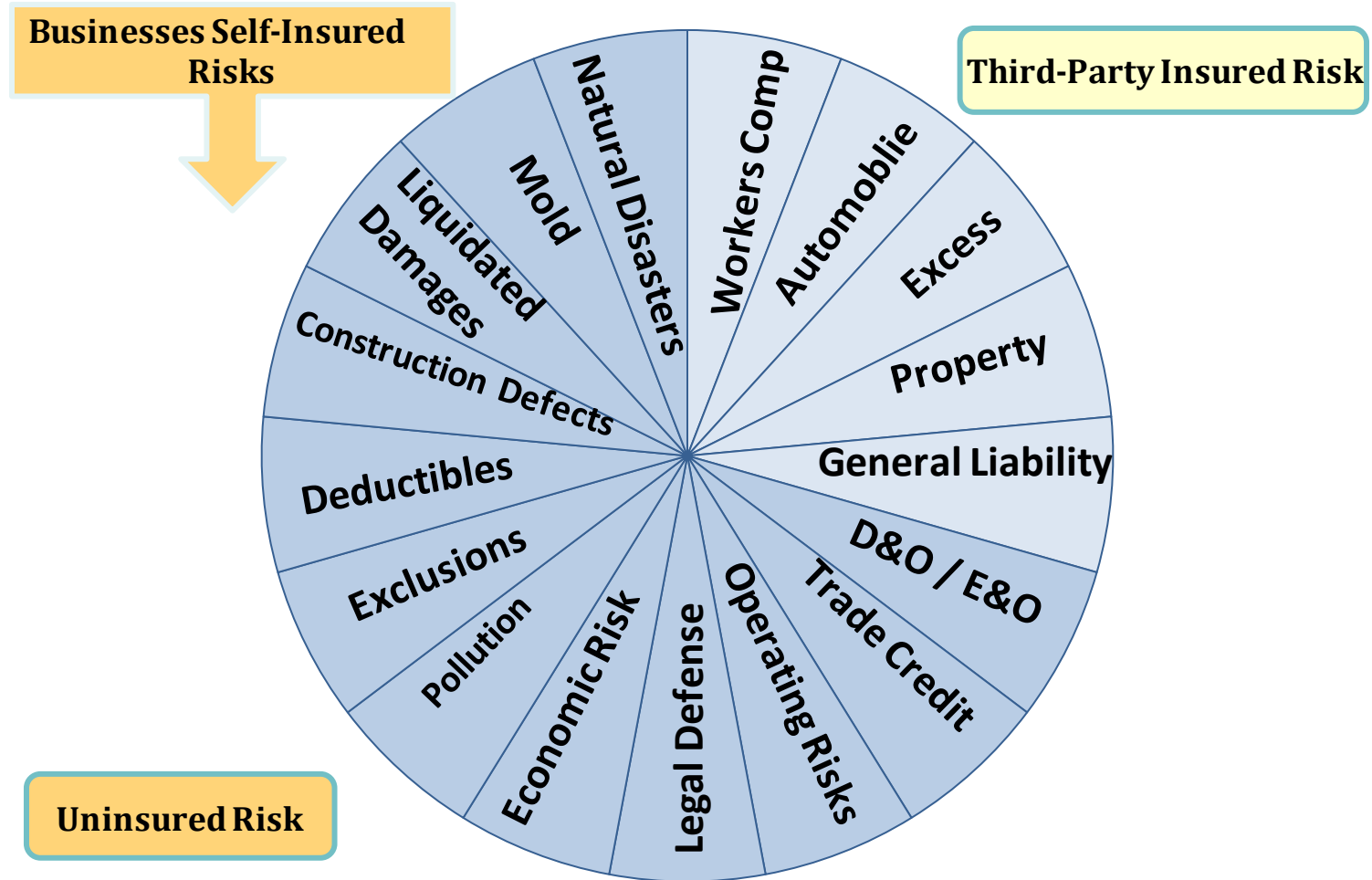


Insurance Company Driven
Alternatives



Insured Driven
Alternatives

Part I: Underwriting & Business Plan Development: The “What”



Part I: Underwriting & Business Plan Development: The “When”

When is the Underwriter engaged in the captive process?

- Formation
- Implementation
- Ongoing Management

Part I: Underwriting & Business Plan Development: The “Where”

Where will the captive be domiciled?

Domicile Requirements: Underwriting / Actuarial

Onshore versus Offshore

Part I: Underwriting & Business Plan Development: The “Why”

Why do you go into the business of Insurance?

CONTROL:

- The best in class subsidize the worst in class
- Phenomenon of the law of large numbers
- Harness Profits: Make \$\$\$\$
- Better Manage Risk & Losses
- Customization
- Access to Reinsurance Markets

Part I: Underwriter as the Quarterback

- Risk Management
- Legal Counsel
- Reinsurance Intermediaries
- Insureds
- Actuary
- Auditor

Part II: Underwriting

“Forest for the Trees”: Devil is in the Details

Underwriting Best Practices: The “How To”

- Establishing the Underwriting Play Book
 - Underwriting Methodologies:
 - Coverages
 - Rating
 - Premiums
 - Capacity

Part II: Underwriting

“Forest for the Trees”: Devil is in the Details

Underwriting Best Practices: The “How To”

■ Underwriting Tools & Their Importance

- The “Arms Length” Approach
- “If it Quacks like a Duck, it is a Duck”
- Premium Justification
- Makes Actuaries Feel Warm & Fuzzy

Part II: Underwriting

“Forest for the Trees”: Devil is in the Details

Underwriting Best Practices: The “How To”

- Types of Underwriting Tools
 - ❑ ISO Rating
 - ❑ Loss Trending & Development Analysis
 - ❑ Third Party Market Indications
 - ❑ Industry Benchmarks & Data Services
 - ❑ Financial Underwriting
 - ❑ The “WAG” Factor
 - ❑ Actuarial Review

Part II: Underwriting

“Forest for the Trees”: Devil is in the Details

Underwriting Best Practices: The “How To”

- Underwriting Resources
 - ❑ ISO
 - ❑ Advisen
 - ❑ Zywave
 - ❑ Silver Plume
 - ❑ Your Local Underwriters
 - ❑ Other Professionals (i.e. captive managers, actuaries)
 - ❑ When all else fails, Google It (not really)

Part II: Underwriting

“Forest for the Trees”: Devil is in the Details

Underwriting Best Practices: The “How To”

- Policy / Contract Language
 - Manuscripted Policy Forms
 - Issuance of Policy Forms
 - Endorsements
 - Certificates of Insurance

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums

831 Shades of Grey

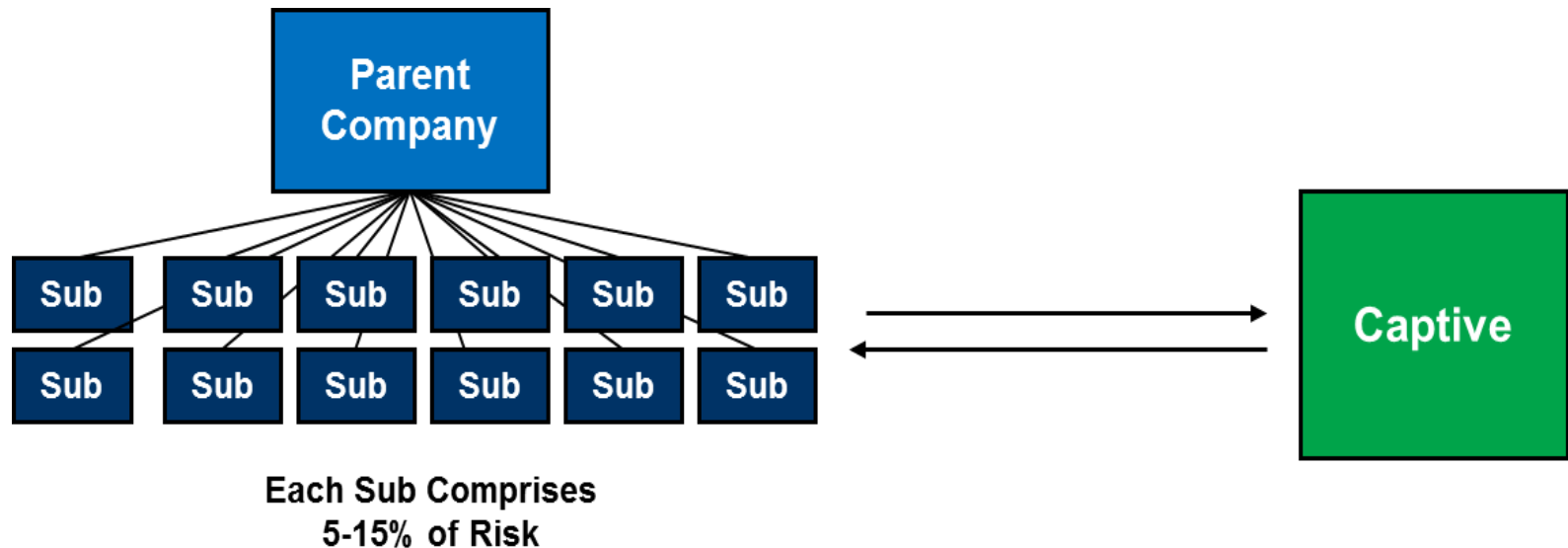
Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools

RISK DISTRIBUTION

➤ Revenue Ruling 2002-90

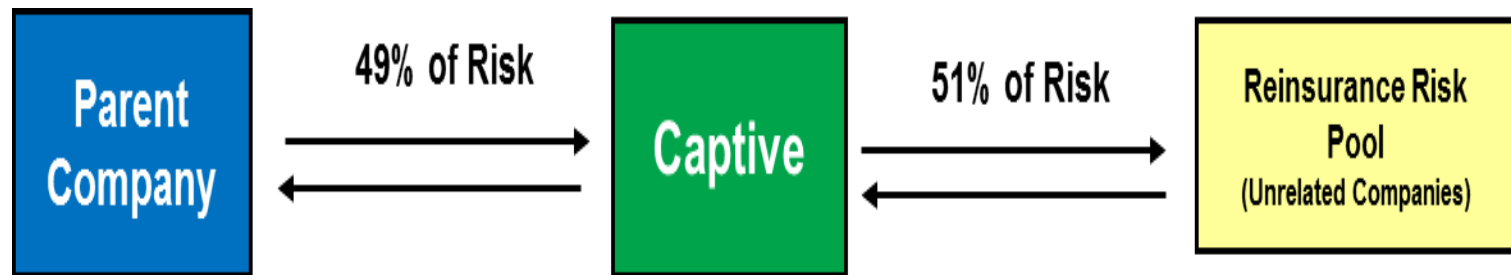
- Multiple Subsidiaries (12) – the risk is distributed where a captive sells insurance to enough subsidiaries (who own no stock in the captive)



SAFE HARBOR: UNRELATED BUSINESS EXAMPLE

➤ Revenue Ruling 2002-89

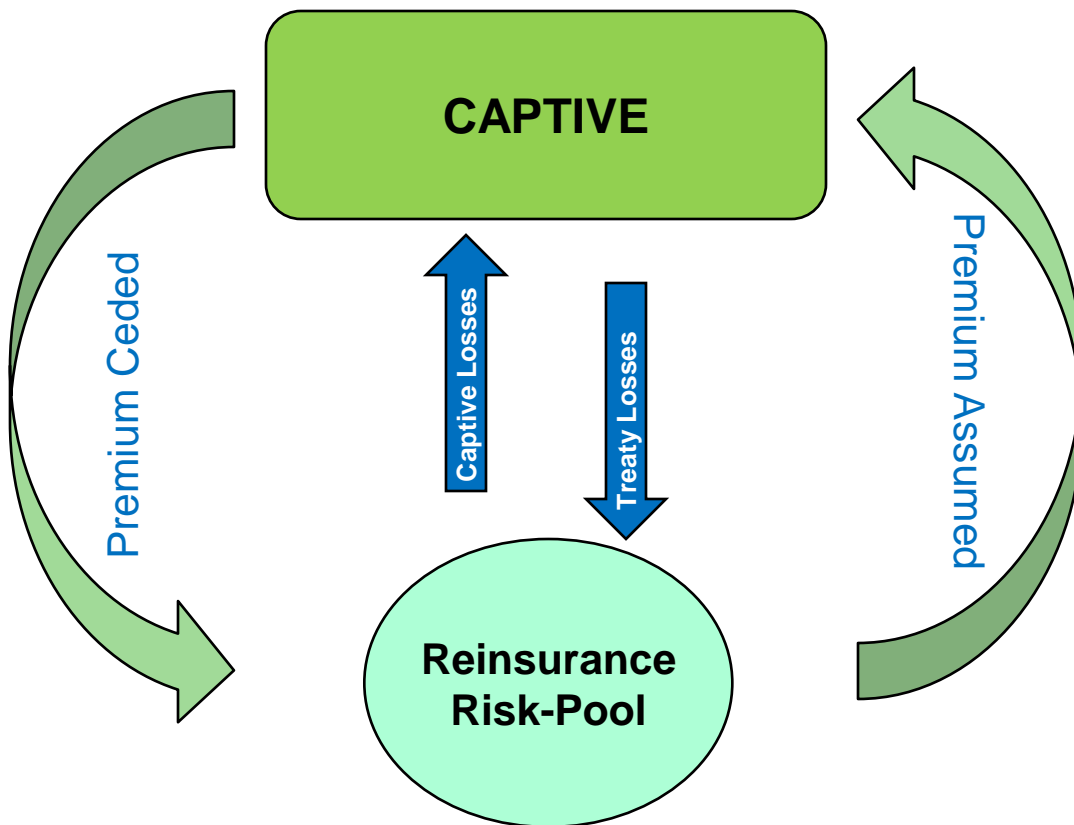
- Greater than 50% of homogeneous risk is derived from a third party (The Tax Court has said 29% is enough (Harper))
- Parent company / primary shareholders also own 100% of captive
- Captive charges arms-length premiums, established by customary rating formulas
- No parental or related party guarantees made in favor of captive
- No loans from captive to parent or insured subs



RISK POOL (REINSURANCE) CAPTIVES

➤ Revenue Ruling 2002-91: Source of Unrelated Risk – Can Provide a source of recurring third party business by transforming related risk normally retained by a company into unrelated risk.

- Each captive will purchase reinsurance policies with respect to its best insured risks from the other captives within the pooled captive structure
- Multiple entities (more than 12) participate to achieve risk distribution



831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization
- Investments
 - Affiliates
 - Liquidity

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization
- Investments
 - Affiliates
 - Liquidity
- Life Insurance

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization
- Investments
 - Affiliates
 - Liquidity
- Life Insurance
- Loan Backs

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization
- Investments
 - Affiliates
 - Liquidity
- Life Insurance
- Loan Backs
- Experience of Key Personnel

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization
- Investments
 - Affiliates
 - Liquidity
- Life Insurance
- Loan Backs
- Experience of Key Personnel
- Books and Records

831 Shades of Grey

Best Practices for Small Captives – When Do We Cross the Line?

- Acting Like an Insurance Company - Actual Risk / Claims Paid
- Reasonable Premiums
- Risk Distribution
 - Sub Count / Third Party %
 - Risk Pools
- Capitalization
- Investments
 - Affiliates
 - Liquidity
- Life Insurance
- Loan Backs
- Experience of Key Personnel
- Books and Records
- Domicile – Reputation / Regulation / Requirements