

RISK WELL REWARDEDSM

CAPTIVE INSURANCE AND ALTERNATIVE RISK SOLUTIONS FOR THE MIDDLE MARKET

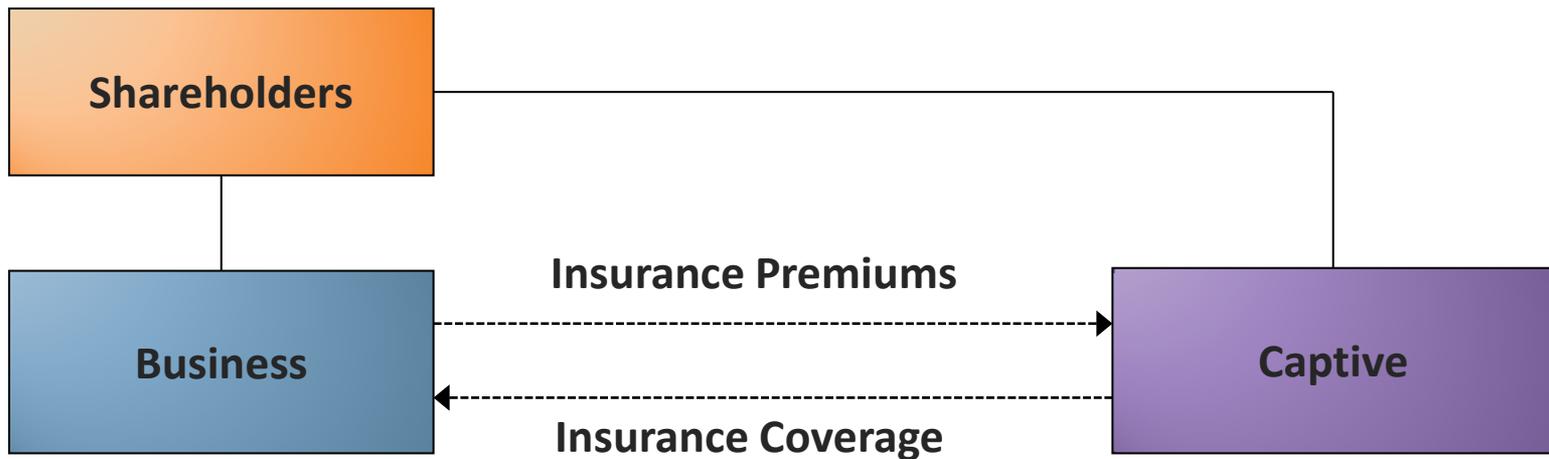
2012 Micro Captive Update



What is a “Captive”?

1. Must be an “Insurance Company”
2. Insureds are related or affiliated

Basic Captive Diagram





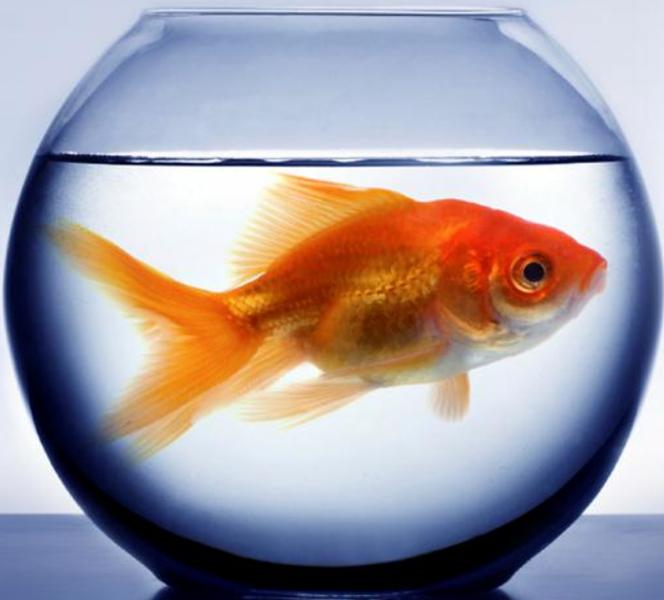


Harvard University

The growth in middle market captives

Fortune 500
Over 80%

Middle Market 106,000 Companies
Less than 5%





Why Form a Captive?

Risk Management

Tax Savings

Cash Flow

Reduce insurance cost
Capture underwriting profit
Pricing stability
Purchase based on need

Greater control over claims
Increase coverage
Increase capacity
Underwriting flexibility
Access reinsurance market
Incentives for loss control

**Minimize
Insurance Cost**

**Improve
Cash Flow**

**Control
Risk**

**Wealth
Accumulation**

Retain premium dollars
Tax benefits
Investment income
Additional profit center

Estate planning
Asset growth
Asset protection

Who is a Candidate?

Business with Substantial Risk

May be insured or self-insured

Key Industries:

Real Estate Developers / Builders

Manufacturers

Professional Services Firms

Franchisees

Restaurant / Hotel Chains

Physicians / Groups





Who is an Ideal Candidate?

Good candidates generally meet one or more of the following criteria*:

- ✓ \$20M+ gross revenue
- ✓ Pre-tax profits of at least \$1M
- ✓ Substantial self-insured / uninsured business risk
- ✓ 50+ employees

*Smaller businesses with at least \$3M revenue can work for some captive programs.

Top Risk Concerns Facing Companies Today ^{1,2,3}

Economic slowdown

Regulatory / legislative changes

Increased competition

Damage to reputation / brand

Failure to innovate / meet
customer needs

Failure to attract or retain top
talent

Business interruption

Commodity price risk

Technology failure / system failure

Cash flow / liquidity risk

1 Aon Corporation, Global Risk Management Survey 2011

2 Respondents reported number of occurrences in each of these risk areas within the past year, with occurrence rates ranging between 8% to 67%

3 Number of respondents reported feeling adequately prepared for these risks: 69%

An iceberg floating in the ocean. The tip of the iceberg is above the water line, and the much larger, submerged part is below. The sky is blue with light clouds, and the water is a deep blue. The iceberg is white and jagged.

**Traditional
Captive**

Insured Risk

Workers Comp ● Property ●
Auto ● General Liability

**Hidden Risks
Micro
Captive**

Uninsured Risk

Deductibles

Exclusions

Operating Risks

A/R Concentration

Construction Defect

Credit Default

Disability

Administrative Actions

D & O / E & O

Legal Defense Reimburse

Mold and Pollution

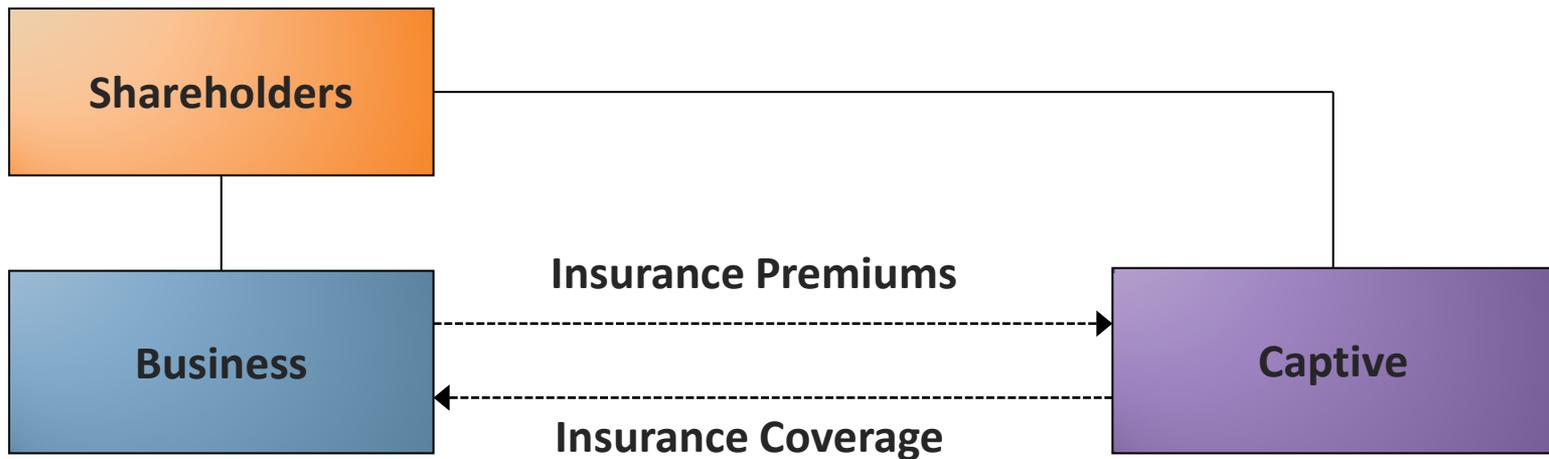
Product Warranty

831(b) Captive

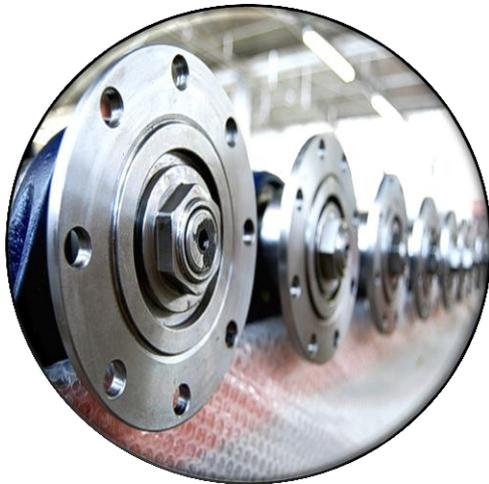
No tax on underwriting profit if premium under \$1.2M

Investment Income taxed as regular “C-Corp”

Basic Captive Diagram

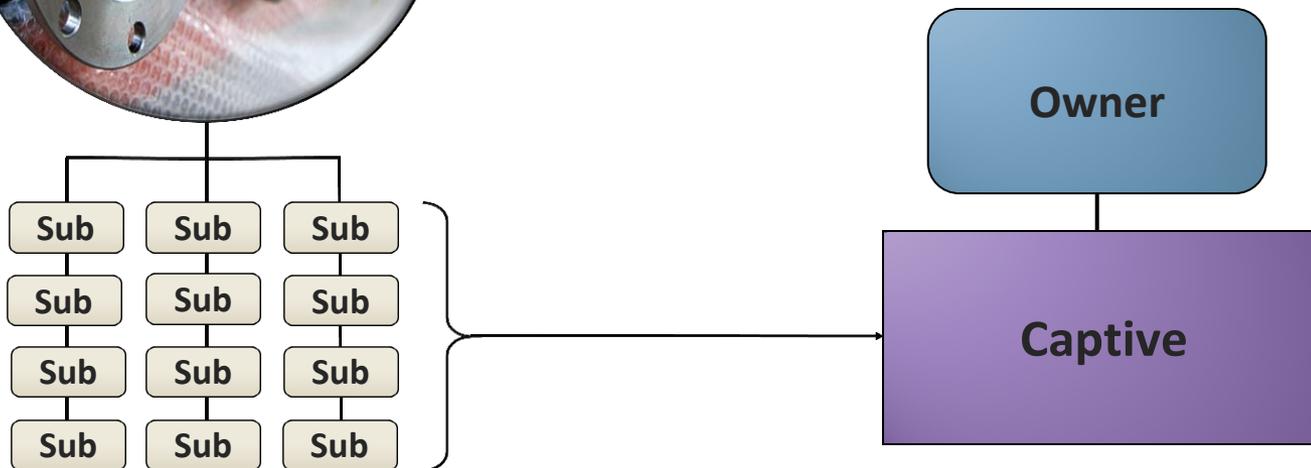


Case #1: Manufacturer



\$50M gross revenue

Significant self insured risk

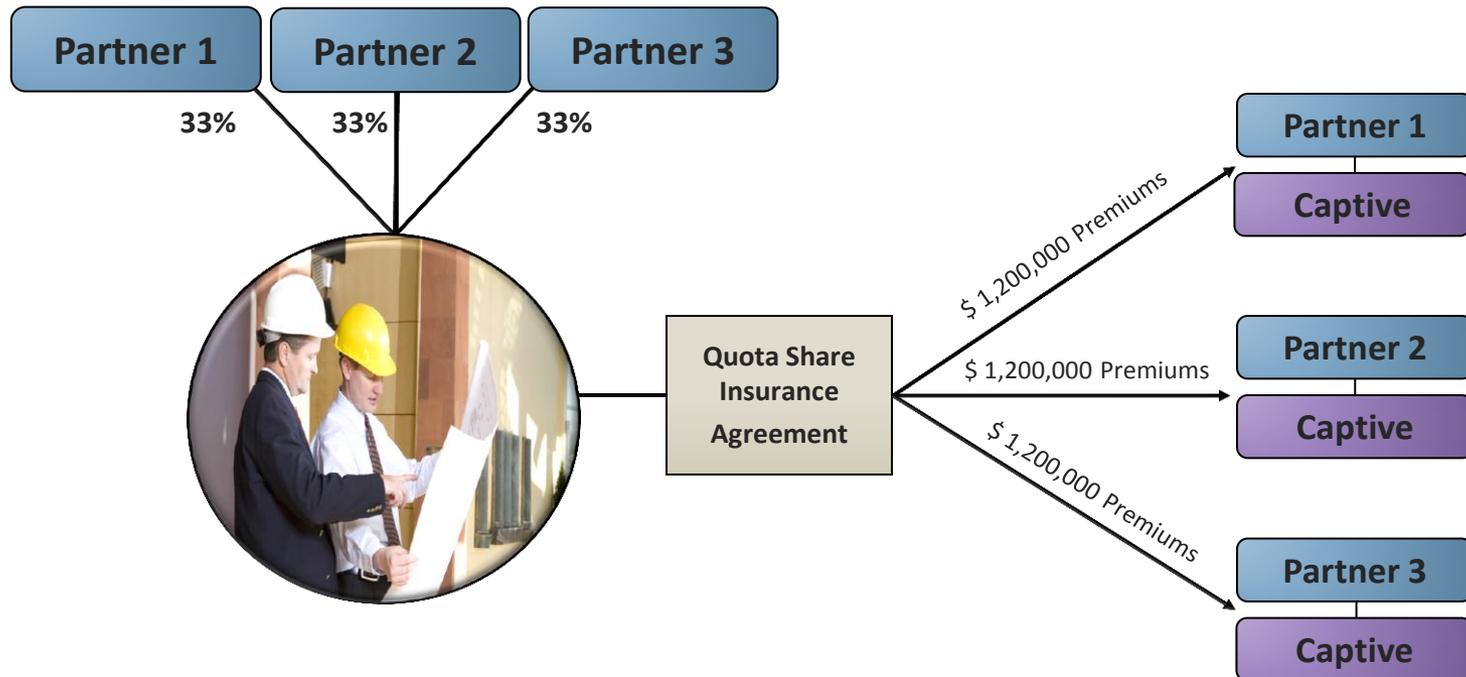


Case #2: Developer

Builder (\$170M gross revenue)

Residential/commercial construction

Unable to purchase construction defect or mold insurance



Case #3: Trucking Company



\$2,400,000 Premiums

Quota Share Insurance Agreement

\$1.2m Premiums

\$1.2m Premiums

Mom / Dad

Child Trust #1

LLC

Captive

Mom / Dad

Child Trust #2

LLC

Captive

Self Insured Risk (SIR)

Litigation Defense

Deductible Coverage

EPLI

Case #4: Physician

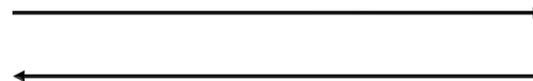
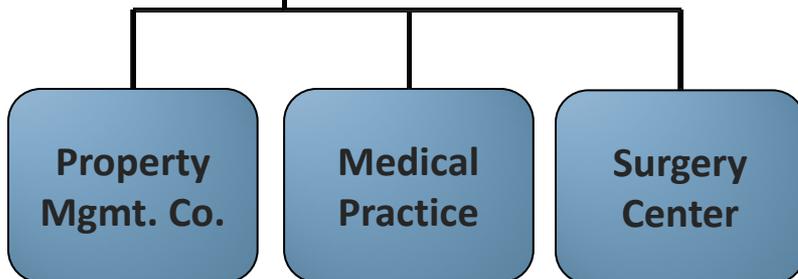
Owns other businesses

Self Insured Risk (SIR)

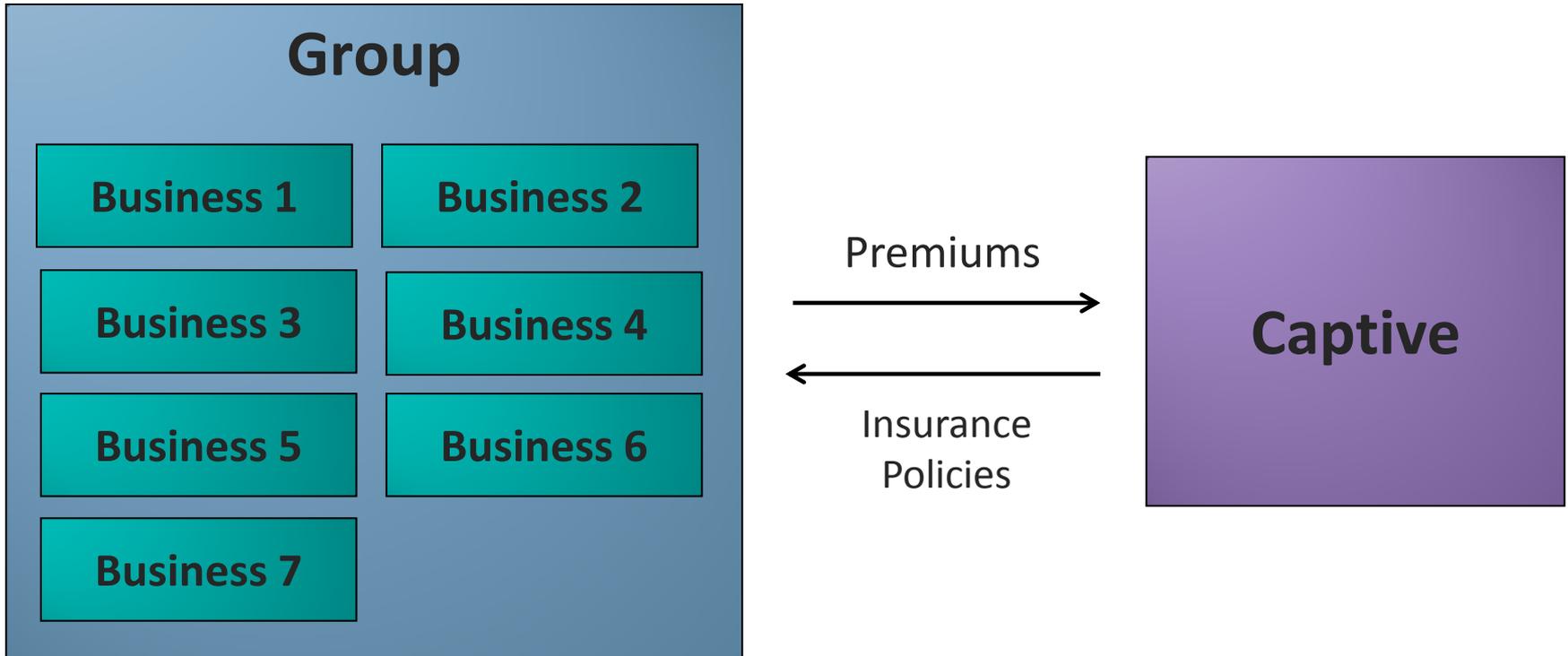
Employment Practices

Litigation Defense Reimbursement

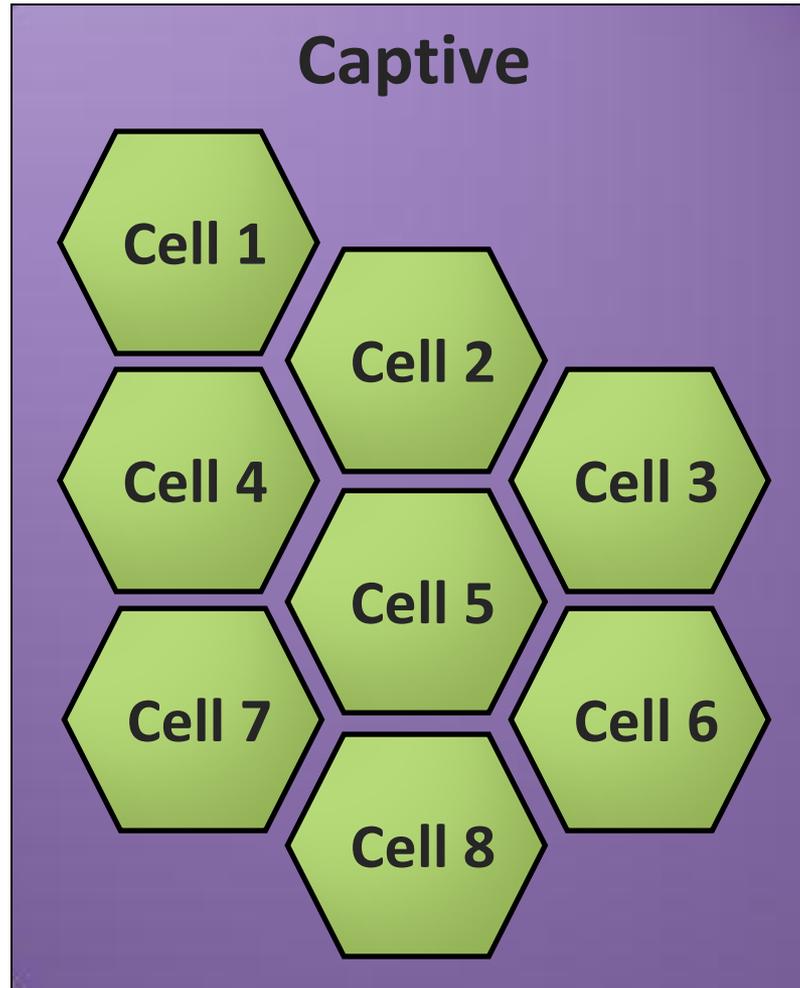
Loss of License



Case #5: Group Captive

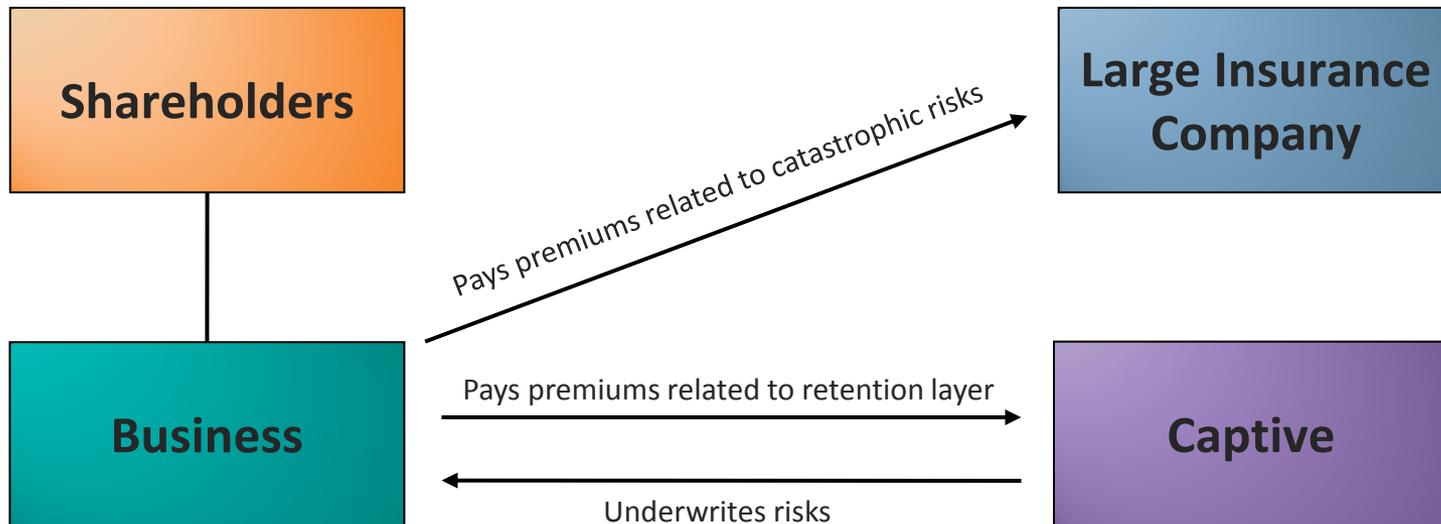


Case #6: Cell Captives

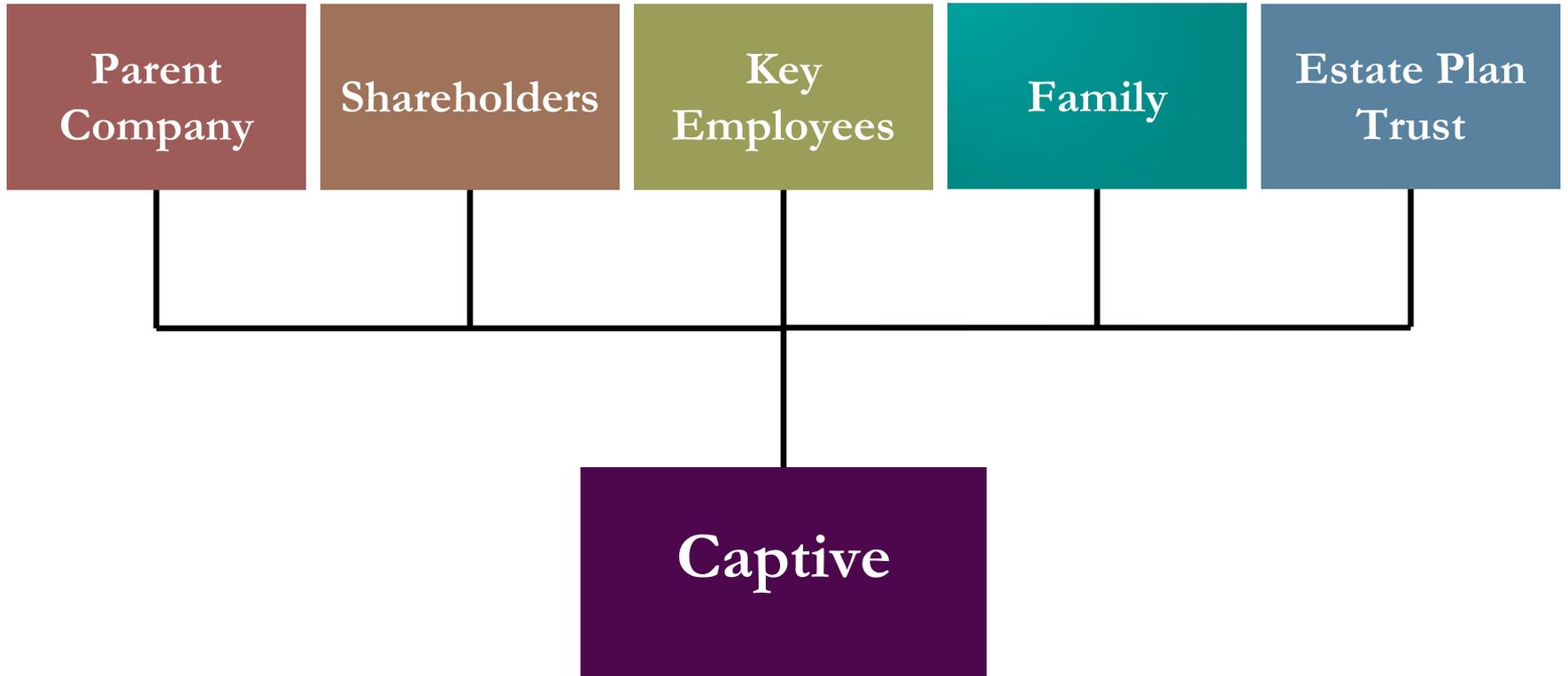


Case #7: Saving Insurance Cost with IRC § 831(b) Captive

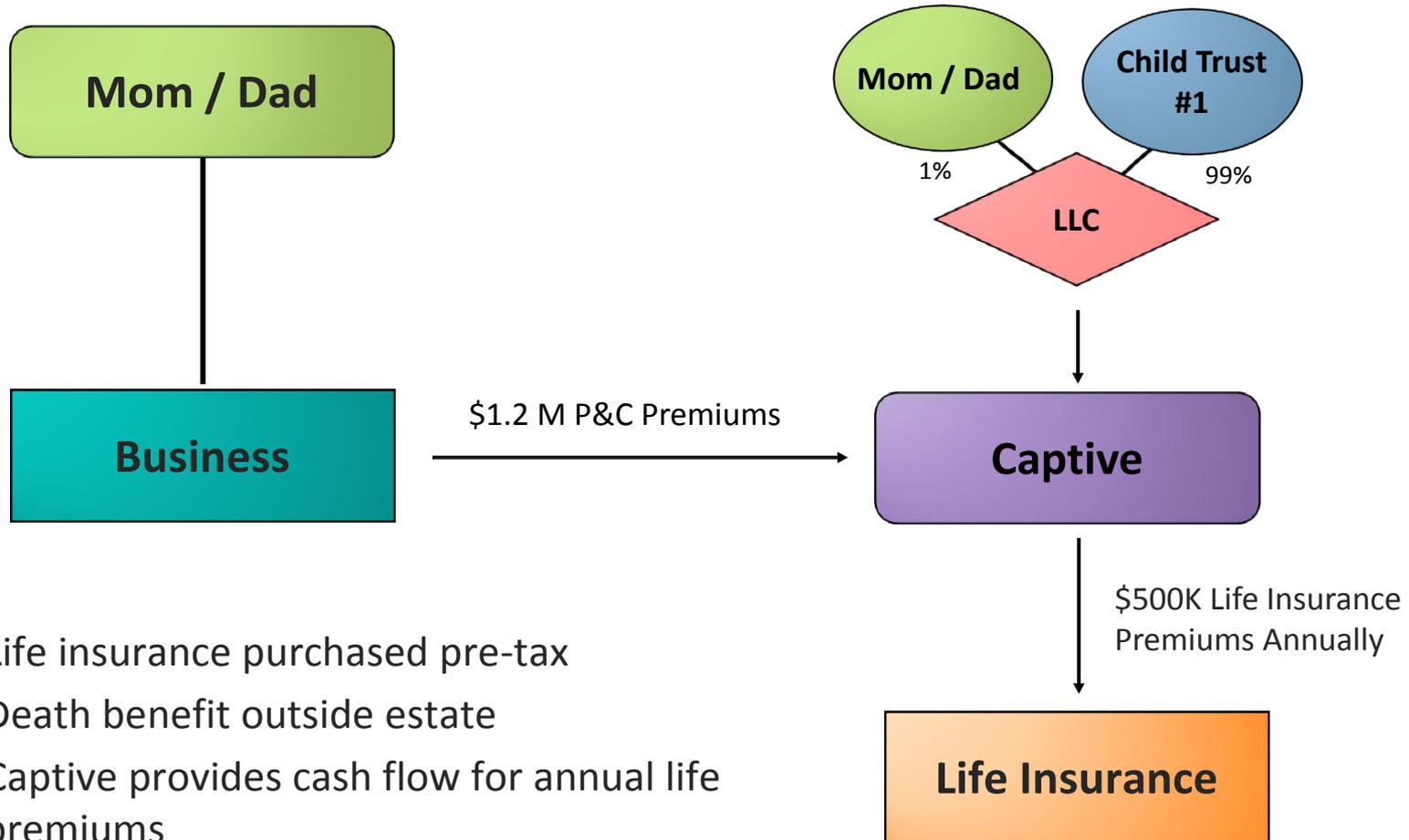
Large insurance program stays in place



Ownership Options



Estate Planning With a Captive (Including Life Insurance)



Where is the Captive Formed?

Offshore

Examples:

Anguilla, Bermuda, BVI, Cayman Islands

Lower capital requirements

Expedited formations

Investments stay in U.S.

Foreign Captives File U.S. tax return
(if 953(d) election made)

Where is the Captive Formed?

Onshore

Examples: Delaware, Utah, Nevada, Vermont, Montana

More states adding captive insurance law

Delaware competitive with offshore “benefits”

Note: Whether foreign or U.S., the tax benefits are the same

Leading Captive Domiciles

Rank	Location	Captives (as of 12/31/2010)
1	Bermuda	845
2	Cayman Islands	738
3	Vermont	576
4	Guernsey	333
5	Anguilla	252
6	Luxembourg	249
7	Barbados	242
8	BVI	219
9	Utah	188
10	Hawaii	168
11	South Carolina	160
12	Isle of Man	142
13	Kentucky	127
14	Dublin	125
15	Nevada	124
16	Nevis	109
17	District of Columbia	102
18	Delaware	97

Source: Business Insurance
March, 2011



Then why doesn't every business have a captive?

Key Question



Department of the Treasury
Internal Revenue Service

Does the captive qualify
as an insurance
company under US
Federal Tax law?

Tax Law and Captives

Insurance Risk

Operate as an insurance company

Risk shifting and risk distribution



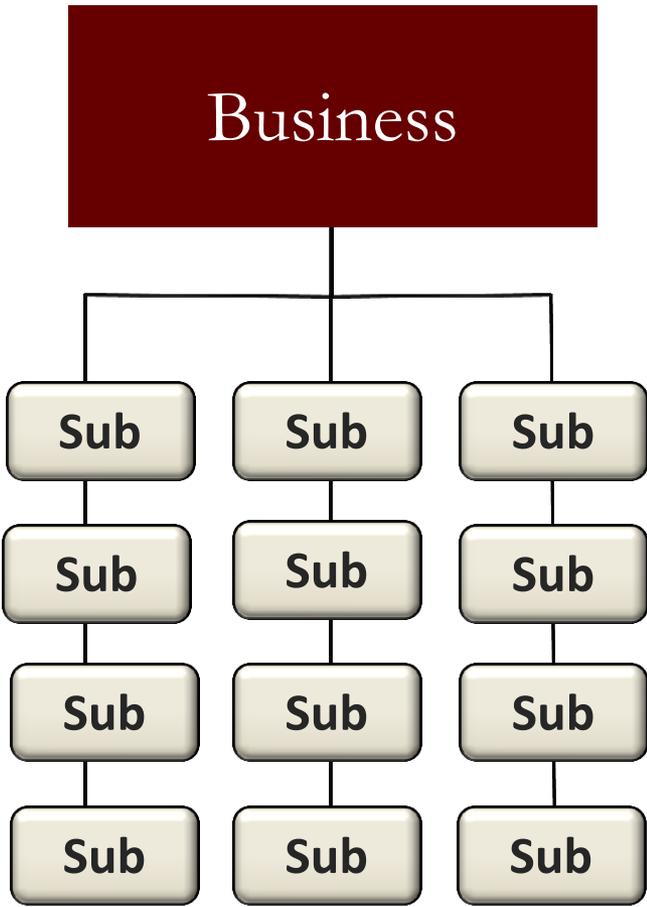
A valid captive requires

“Risk Distribution”



Risk distribution is a spreading of risk that allows the insurer to reduce the possibility that a single costly claim will exceed the amount available to the insurer for the payment of such a claim.

Multiple Subsidiaries



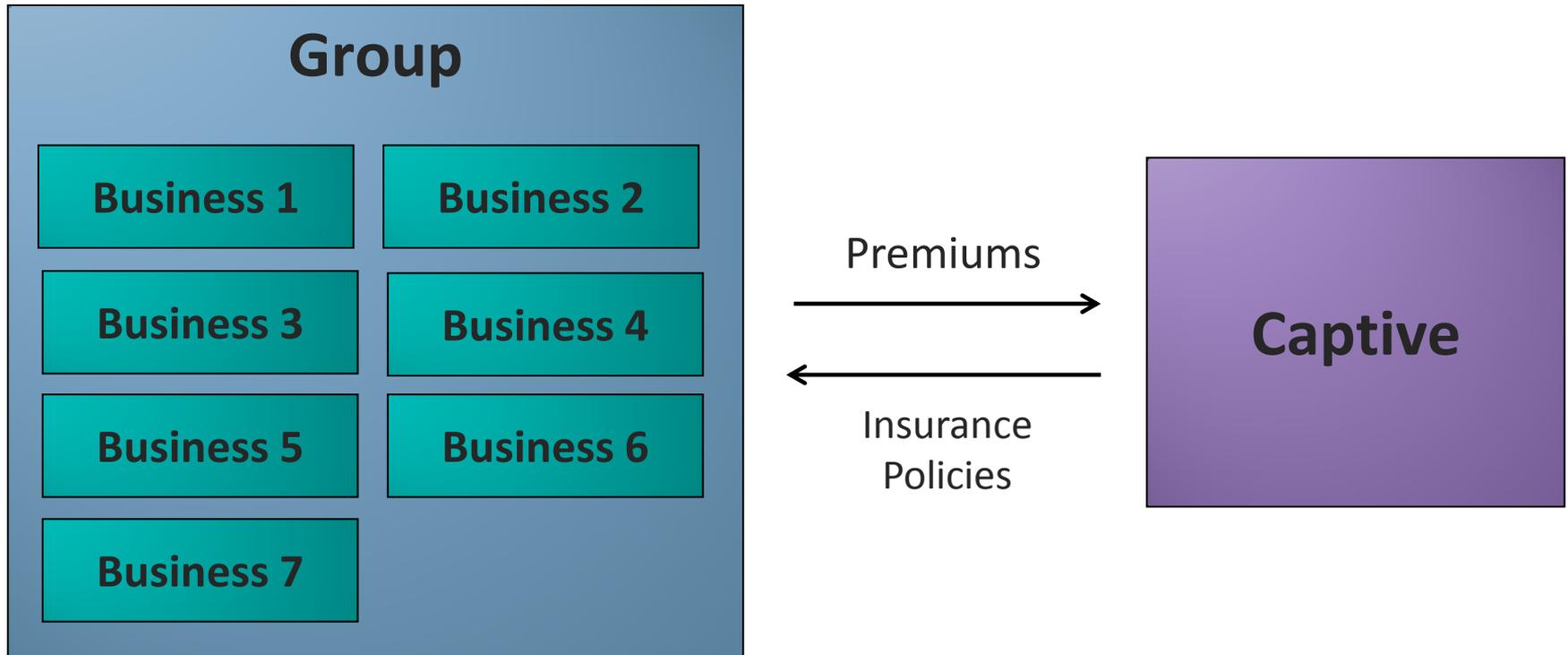
Unrelated Risk



How to meet *risk distribution*

1. Group Captive (Rev Rul 2002-91)
2. Multiple Subsidiaries (Rev Rul 2002-90)
3. Warranty Captive (Rev Rul 2002-89)
4. ArtexExchange (Rev Rul 2002-89)
5. Artex Pool (Rev Rul 2002-89)
6. Employee Benefit Captive (Rev Rul 2002-89)

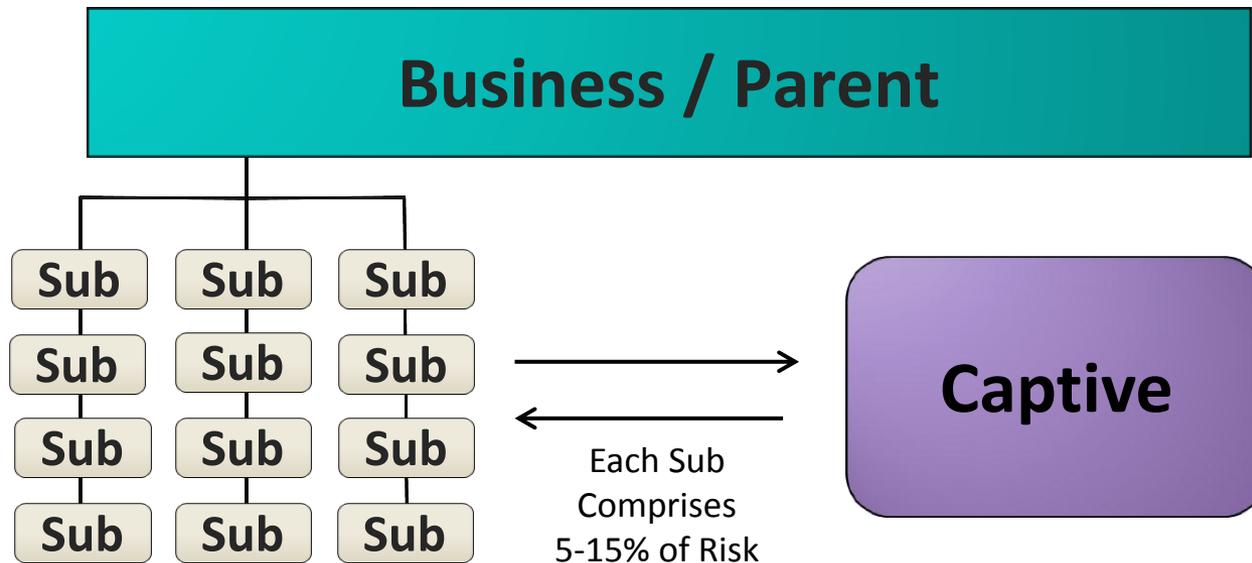
Safe Harbor Revenue Ruling 2002-91



Safe Harbor Revenue Ruling 2002-90

12 Brother / Sister subsidiaries

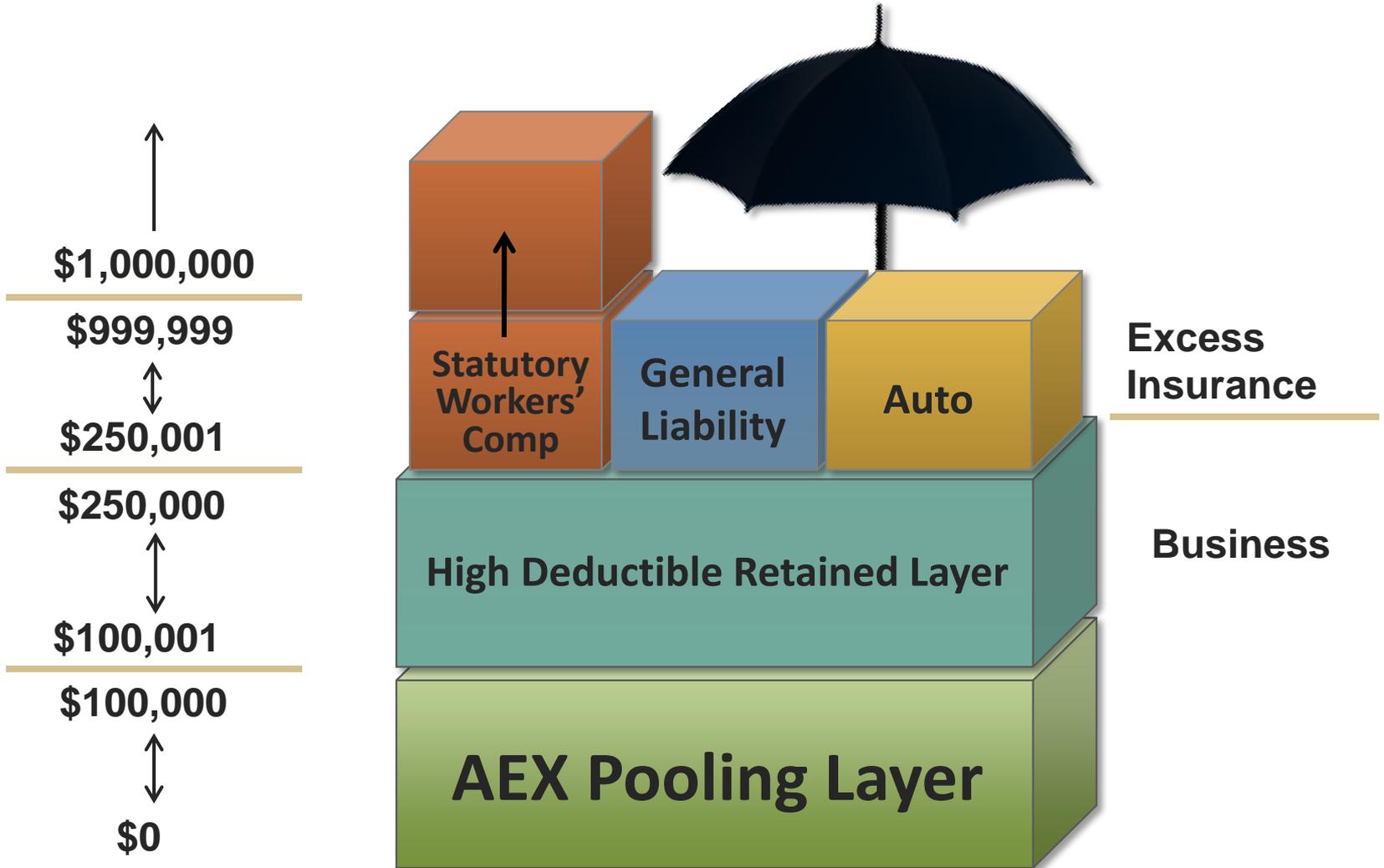
No single Brother / Sister subsidiary can constitute greater than 15% or no less than 5% of the risk

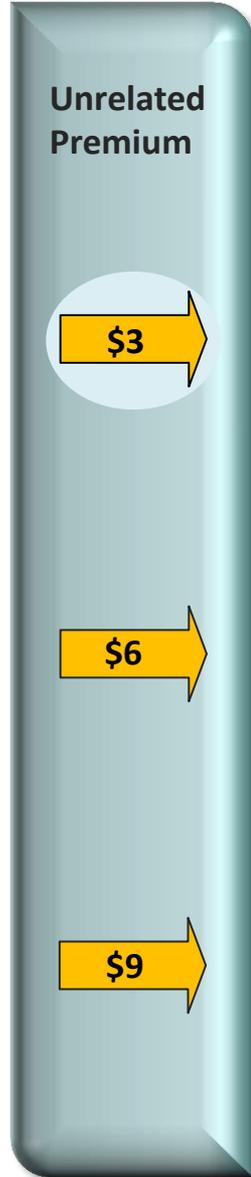
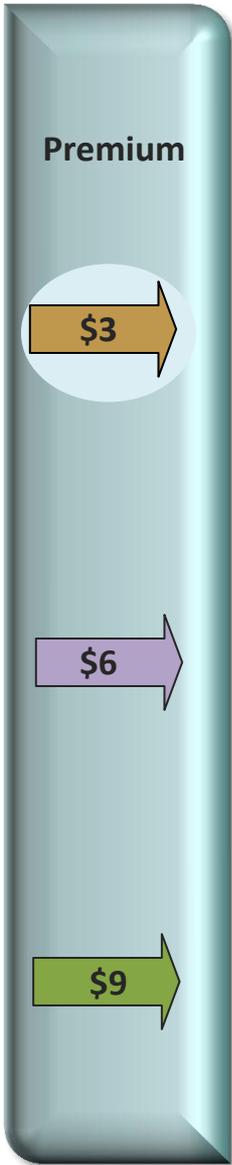


The logo for Artex Exchange features the letters 'A', 'E', and 'X' in a stylized font. The 'A' is white, while the 'E' and 'X' are gold. The 'E' is composed of three horizontal bars. To the right of the 'X', the words 'Artex Exchange' are written in a white, sans-serif font. The logo is set against a dark purple background.

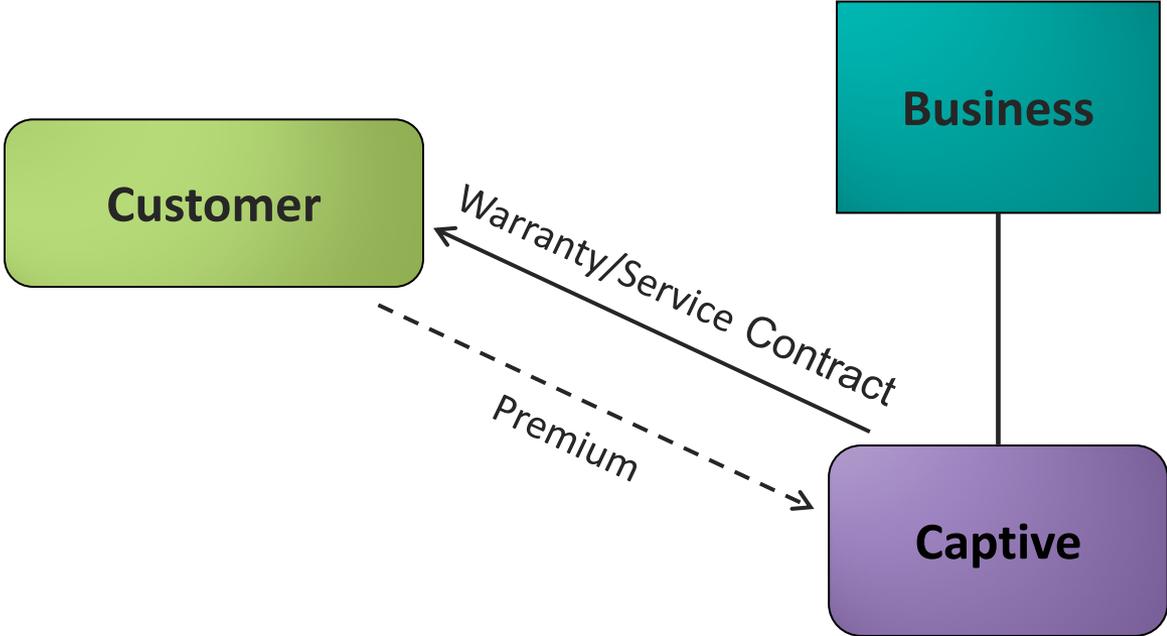
AEEX Artex Exchange







Warranty Captive



Example: HVAC Contractor

- Cost of new A/C Unit: \$5,000
- Contractor sells 2,000 units per year
- Allocate \$500 (of the \$5,000) to a 3-year Service Contract
- Premium to Captive: $\$500 \times 2,000 = \1M
- What is the net benefit?

Assumptions:

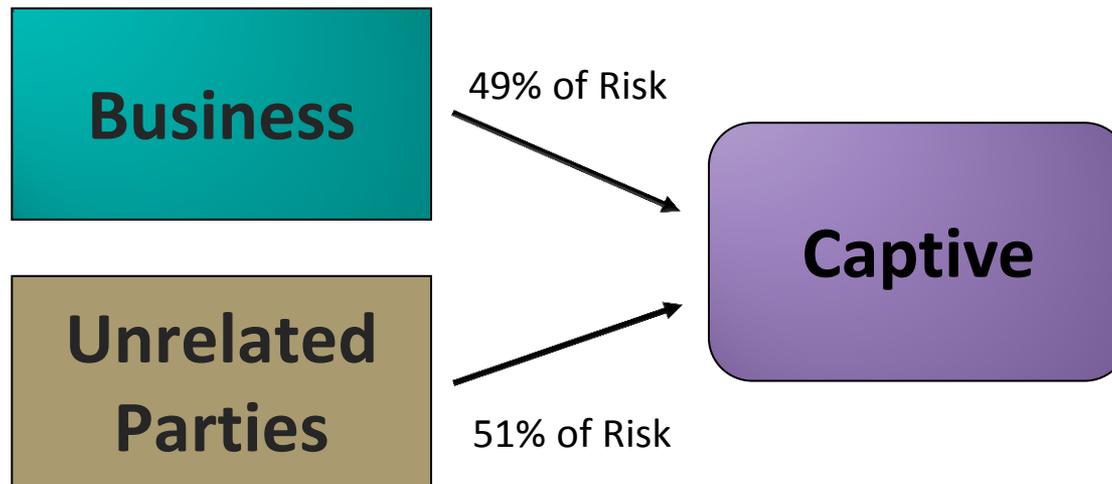
- \$1,000,000 annual premium
- 30% claims (3% per year for 10 yrs)
- 10-year period
- Captive costs included
- 40% tax rate
- 6% investment growth per year

Pro Forma - \$1 million premium

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 10
Premium	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Expenses	(80,000)	(80,000)	(80,000)	(80,000)	(80,000)	(80,000)
Growth	54,400	108,204	164,496	222,366	281,908	608,431
Claims	(30,000)	(60,000)	(90,000)	(120,000)	(150,000)	(300,000)
	943,400	968,204	994,496	1,022,366	1,051,908	1,228,431
Net Value of Funds	943,400	1,911,604	2,906,100	3,928,466	4,980,374	10,748,941
Net Value of Funds without ins. co.	640,200	1,276,452	1,931,799	2,607,387	3,304,430	7,159,334
Net Benefit	303,200	635,152	974,301	1,321,079	1,675,944	3,589,606

Safe Harbor Revenue Ruling 2002-89

More than 50% of risk exposure from unrelated parties



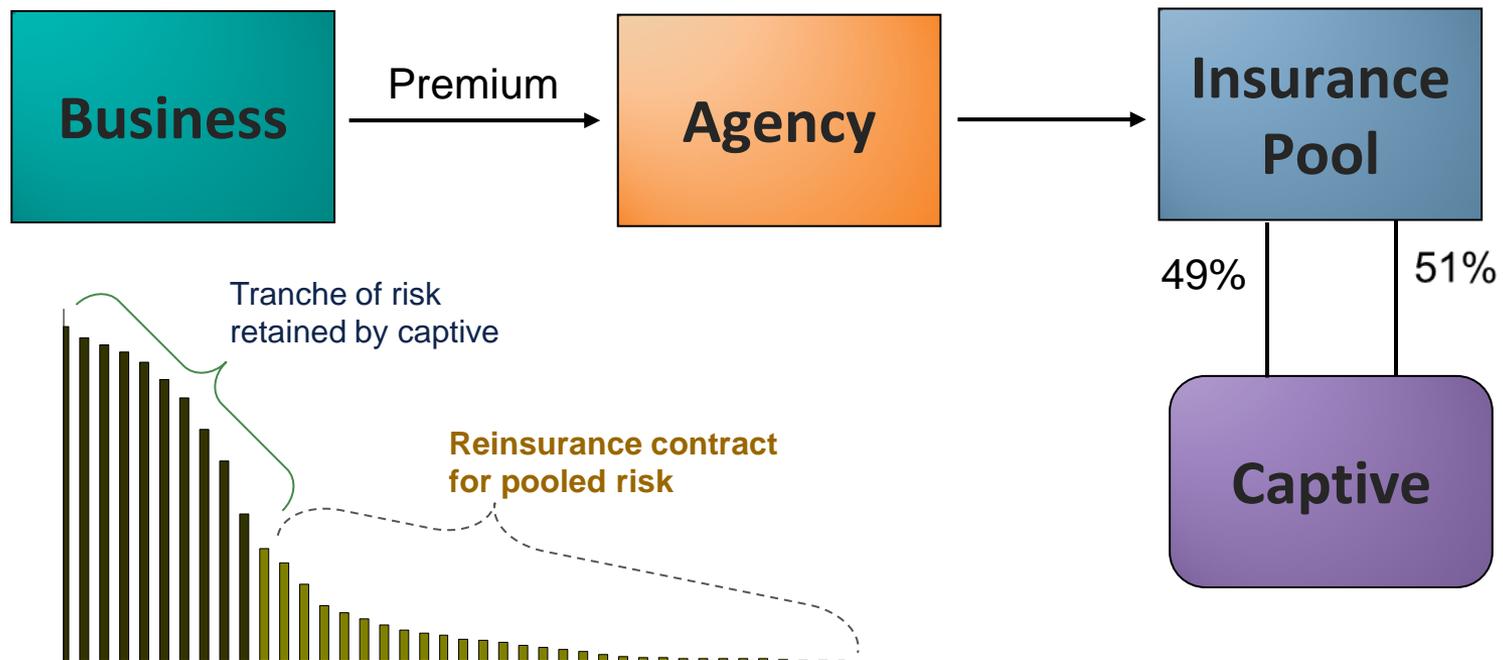
Artex Pool

Low \$ / high frequency claims (paid by captive)

49% of risk / premium

Low frequency / high \$ claims (paid by risk pool)

51% of risk / premium



Employee Benefits Captive



Types of Employee Benefit Captives

Fortune 500

- DOL Approval
- ERISA Exemption (PTE)
- Can use EE \$
- Risk Distribution: yes
- Group Health, life, disability, other
- Under 30 captives

Middle Market

- No DOL Approval
- ERISA Exemption
 - No EE \$
- Can only use ER \$
- Risk Distribution: no
- Group Health
- Size: 50-1,000 EEs covered
- Big growth area

Wantage

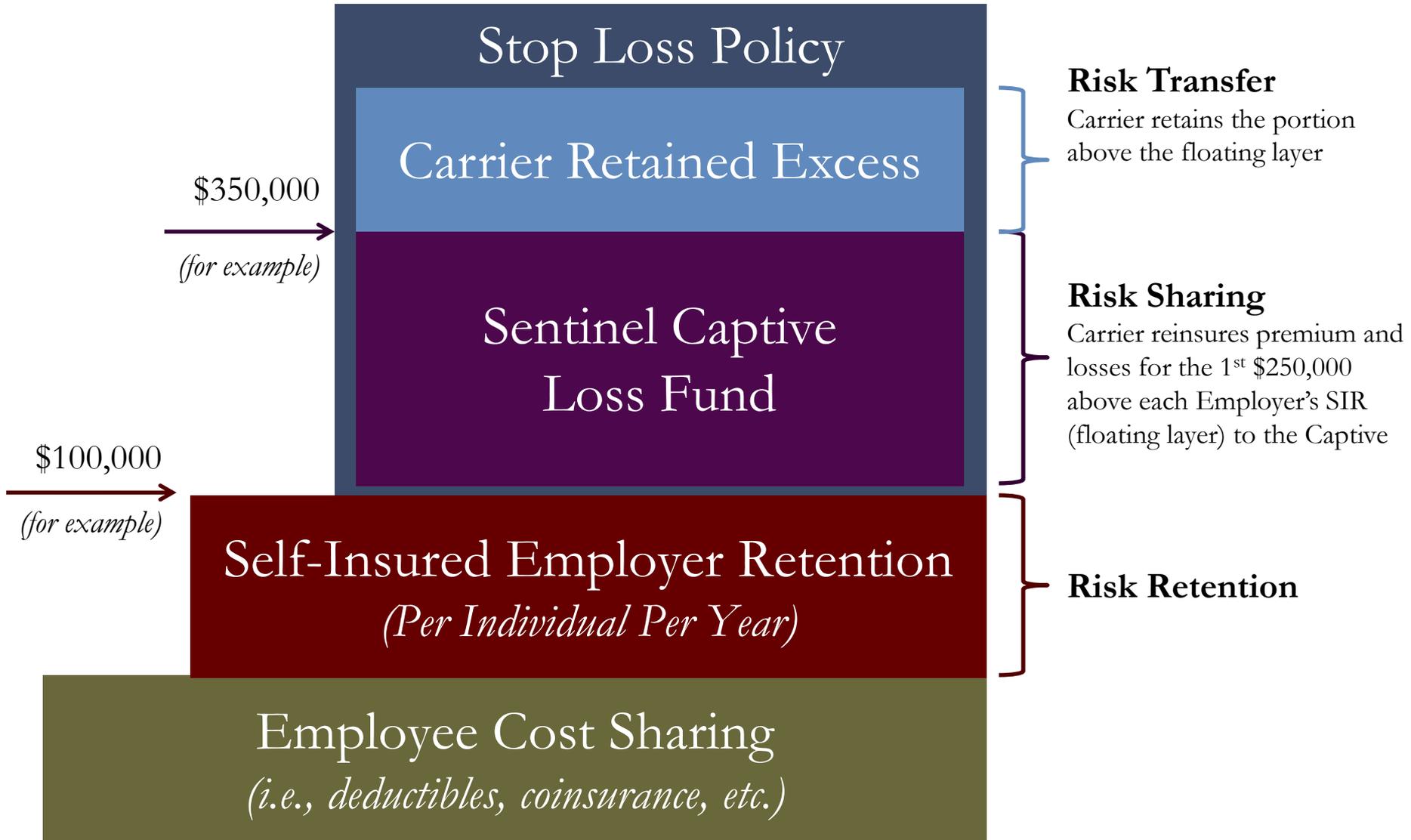
Driving down the cost of
employer health care

A top-down view of various baking ingredients and tools on a dark wooden surface. In the top left is a white bowl of brown sugar. In the top right is a white bowl of white flour. In the center are two brown eggs. To the right of the eggs is a metal whisk. In the bottom left is a white bowl of dark chocolate chunks and a glass jar of white milk. In the bottom right is a dark grey silicone mold.

Vantage Recipe

1. Self Funding Layer
2. Captive Layer
3. Stop Loss Insurance
4. Risk Management

Self-Insured Structure with Medical Stop Loss





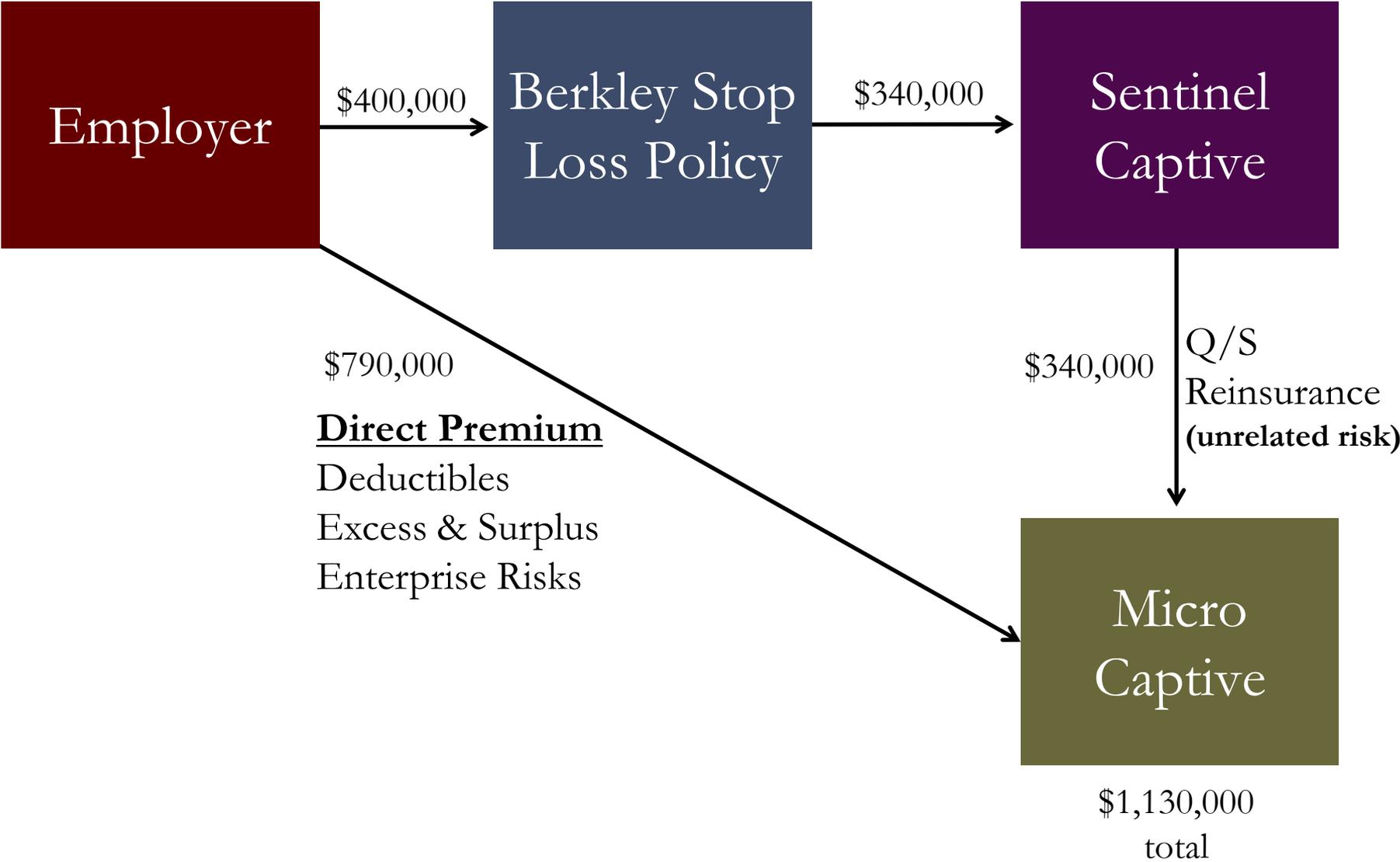
Rated A+ (Superior) by A.M. Best

NYSE: WRB

Subsidiary of W.R. Berkley Co., est 1967

All 50 states

Micro Captive Example Option



Stop Loss Insurance

Captive Layer

Self Funding Layer



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