



Self Insurance and Captive Insurance Revenue Opportunities

Presented by:

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AGENDA

- What is Captive Insurance?
 - The Basics
 - The Numbers
 - The Types and the Risks
 - The Benefits (and Possible Disadvantages)
- Traditional Financial Institution Captive Programs
- Potential Benefit/New Revenue Opportunities for Financial Institutions and Recent Captive Trends
 - First Party
 - Third Party Underwriting Profit Opportunities
 - Third Party Fee Business Opportunities
- Do Your Homework and Build the Right Platform
- Final Thoughts

What is a Captive?

Definition:

A closely held insurance company that is owned and controlled by its insureds

Characteristics

- ▶ A licensed insurance company
- ▶ Formed to insure or reinsure the risks of its owners or related parties of their choosing
- ▶ Regulated under special legislation regulating captives
- ▶ Located onshore or offshore
- ▶ Generally licensed in only one domicile

Where are Captives Formed?

Domicile	2010 Active Licenses (per BI)
Bermuda	845
Cayman Islands	738
Vermont	572
Guernsey	341
Anguilla	252
Luxembourg	244
Barbados	242
Utah	188
Hawaii	168
South Carolina	160
Washington DC	139
Kentucky	127
Nevada	124

Who Uses Captives?

- Publicly Traded Companies
- Large & Mid-Size Privately Held Organizations
- Not-For-Profit Organizations
- Associations or Groups of Individuals or Small Organizations
- Wealthy Individuals
- Insurance Agents/Brokers or Other Similar Service Organizations

Captives – Shapes & Forms

Of Most Interest to You:

- Single Parent or Pure Captives (For You and Others)
- Group/Industrial Insured Captives
- Rent-A-Captives or Protected Cell Captives
- Agency Captives

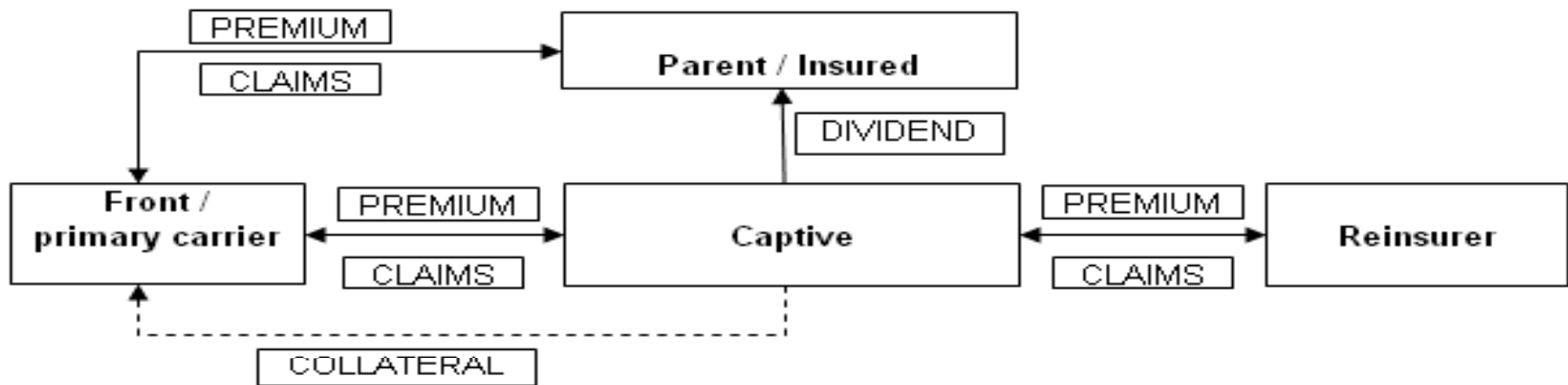
Other Types

- Association Captives
- Risk Retention Groups
- Branch Captives
- Special Purpose Financial Captives

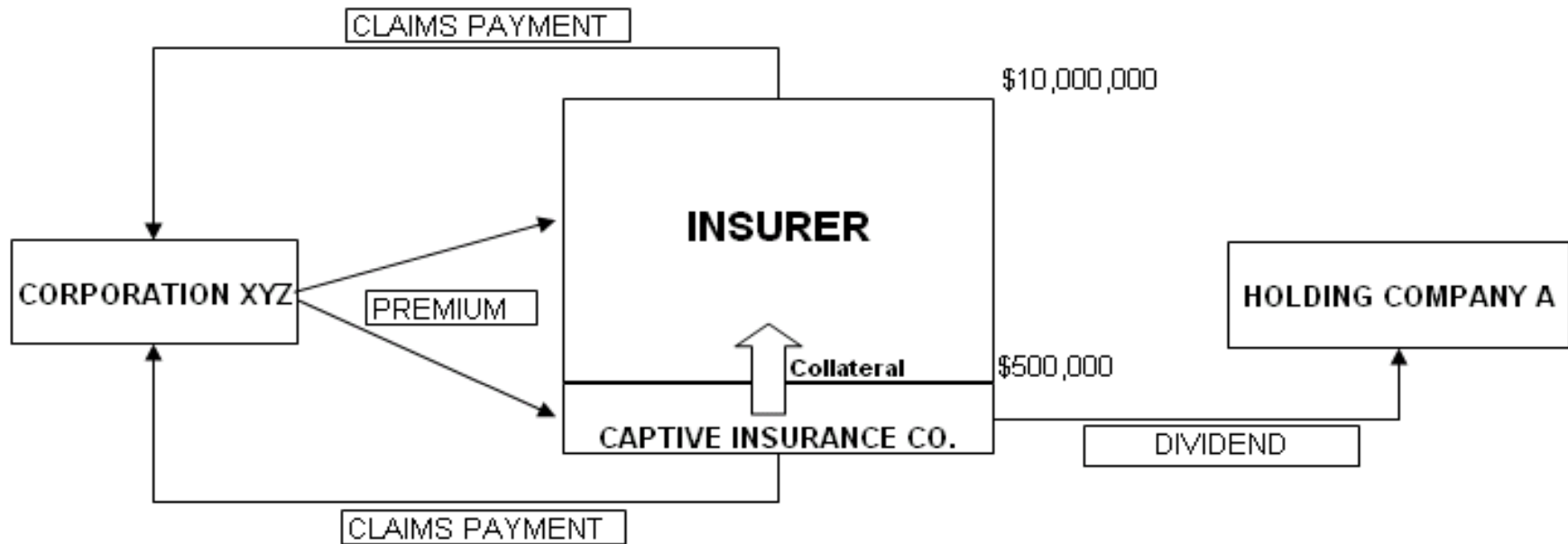
What Risk are Insured in Captives?

- Workers Compensation & Employment Practices
- General & Auto Liability
- Product Liability & Recall
- Professional Liability
- All Risk Property
- Directors & Officers Liability
- Employee Benefits
- Employee Medical
- Exclusions (Flood, Windstorm, Earthquake, Mold)
- Difference in Conditions & Limits (DIC / DIL)
- Sky is the Limit!

Sample Captive - Fronted



Sample Captive - Direct



Potential Captives Benefits

- Stabilize Insurance Budget
- Coverage Availability and Form
- Access to Reinsurance Markets
- Regulate Corporate Deductibles & SIRs
- Improve Claims Handling & Data Collection
- Centralize Risk Management Vehicle
- Reduce Insurance Costs
- Possible Estate Planning & Wealth Transfer Vehicle
- Possible Increase Tax Efficiencies
- Profit Center Creation – Source of New Revenues

Potential Disadvantages

- ▶ Long-term proposition, especially when other than short-tail risks are insured
 - Can be difficult and costly to terminate the captive
 - Requires capital and strong cash flow
- ▶ Management/strategic changes
 - While the captive might be right for your company's environment today, will it be right tomorrow?
 - Management can change
 - Financial condition can change
- ▶ Changing regulation and/or tax rules may negate benefits

Captive Administration

- ▶ Actuary
- ▶ Attorney
- ▶ Auditor
- ▶ Bank (Deposits, Letter of Credit, Trust Accounts)
- ▶ Broker (Primary & Reinsurance)
- ▶ Captive Manager
- ▶ Consultants (Underwriting, Tax, etc...)
- ▶ Investment Manager
- ▶ Third Party Administrator

Captive Commitments

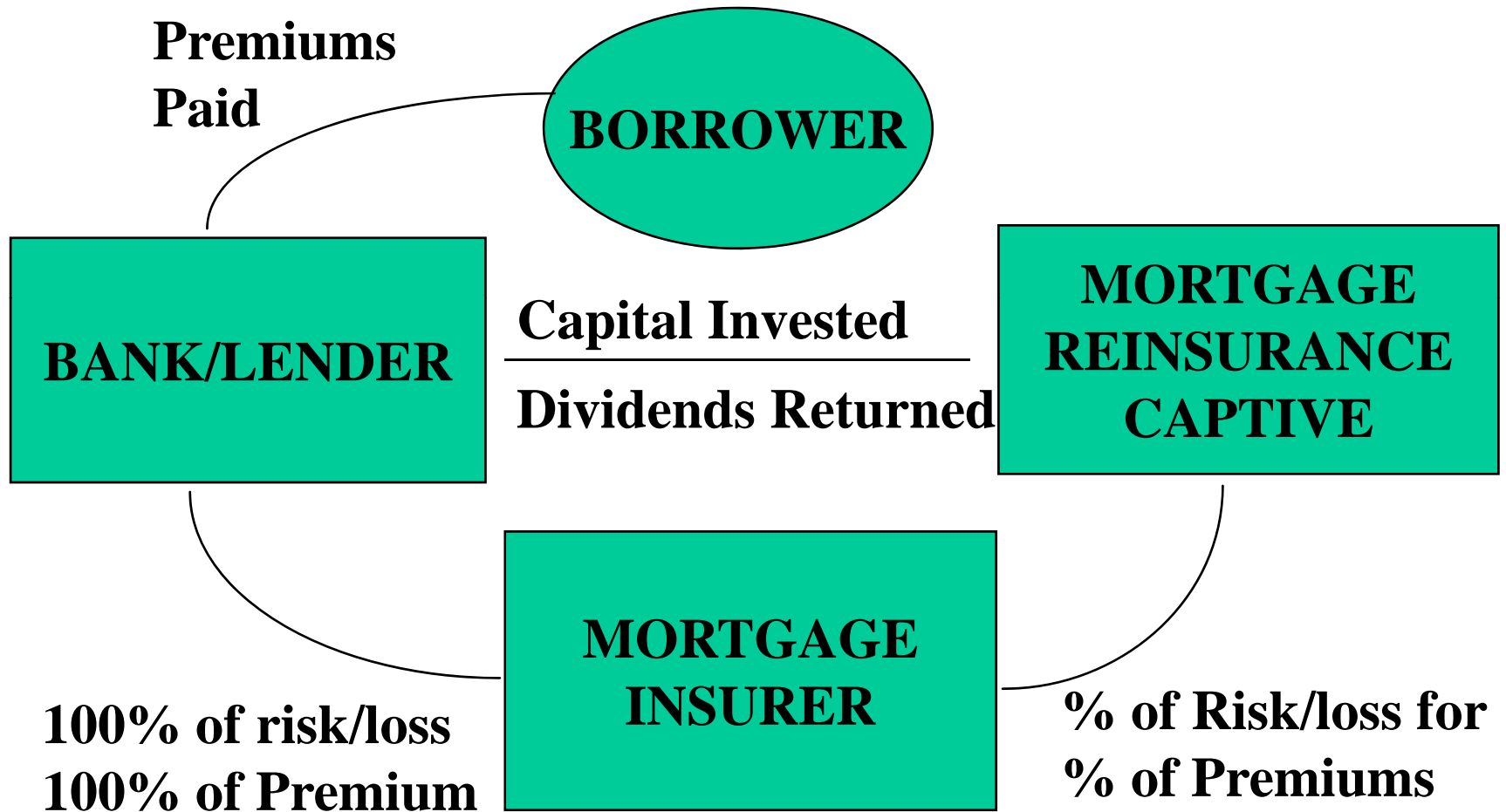
- ▶ Analysis and Formation Costs
- ▶ Capital Contribution
- ▶ Restricted Assets
- ▶ Management Oversight (Time & Dollars)
- ▶ Ongoing Administrative Costs
- ▶ Run-off and Close Down Costs
- ▶ It is a Long Term Proposition!

Traditional Bank Captive Programs

Mainly Used by Large Bank or Financial Institutions

- ▶ First Party Standard Property & Casualty Risks
- ▶ Credit Life & Disability
- ▶ Credit Enhancement
- ▶ Private Mortgage Insurance

Sample PMI Captive



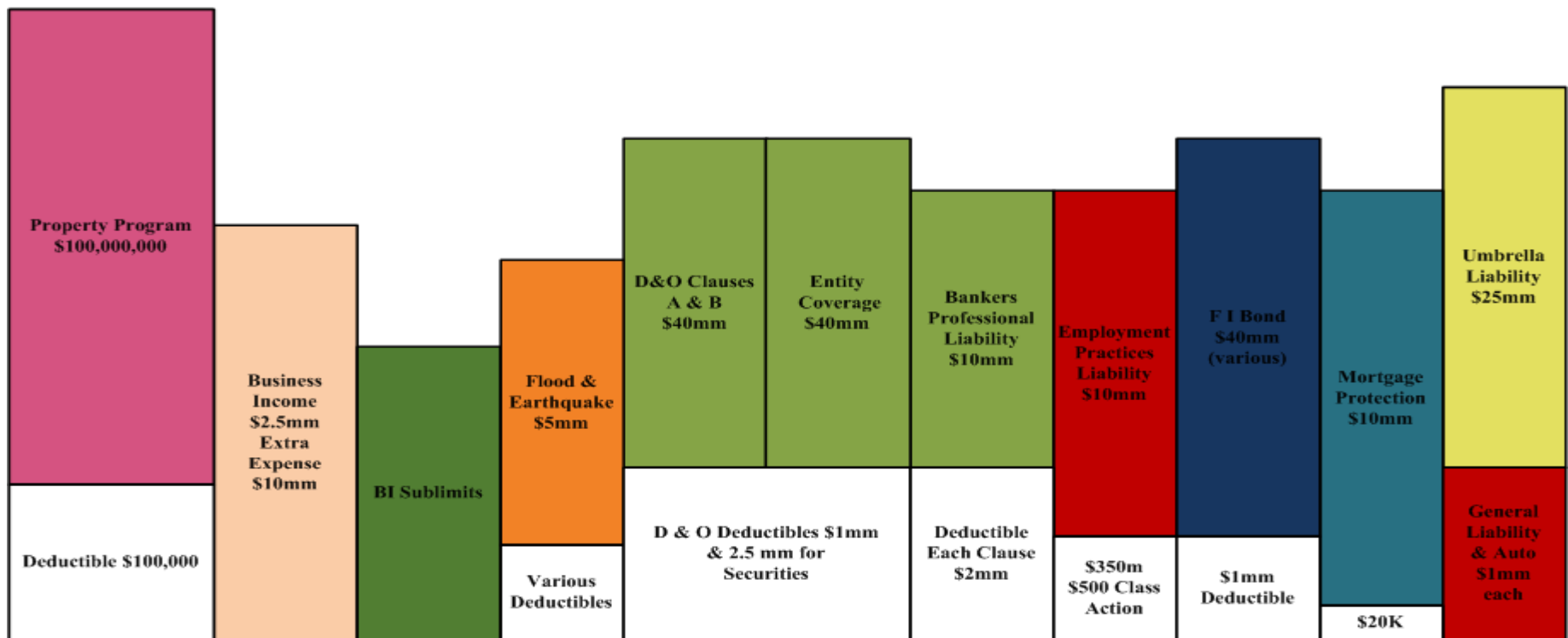
Recent Trend – First Party Risk

Use of Small Captive Insurers by Community Banks

- ▶ Financial Institutions Ranging from \$500M - \$2B
- ▶ Captive Insurer Used to Prefund Self Insured Risks (Known and Unknown)
- ▶ No Change to Risk Profile
- ▶ Budgeting for Volatile Self Insured Risks
- ▶ Financial & Tax Efficiency Maximization

First Party Bank Captive

Example Coverage Prior to Captive Implementation



First Party Bank Captive

Example Coverage Post Captive Implementation



First Party Bank Captive

Status Quo

	Year 1	Year 2	Year 3	Year 4	Year 5
Taxable Income Before Deductible/HRA Expense	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Deductible Expense	-	-	(500,000)	-	-
Deductible Expense II	(553,700)	(553,700)	(553,700)	(553,700)	(553,700)
Net Taxable Income	4,446,300	4,446,300	3,946,300	4,446,300	4,446,300
Net Tax on Company Income (@ 40%)	1,778,520	1,778,520	1,578,520	1,778,520	1,778,520

Captive

	Year 1	Year 2	Year 3	Year 4	Year 5
Taxable Income Before Deductible/HRA Expense	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Deductible Reimbursement Premium	(600,000)	(600,000)	(600,000)	(600,000)	(600,000)
Deductible Reimbursement Premium II	(600,000)	(600,000)	(600,000)	(600,000)	(600,000)
Net Taxable Income	3,800,000	3,800,000	3,800,000	3,800,000	3,800,000
Net Tax on Company Income (@ 40%)	1,520,000	1,520,000	1,520,000	1,520,000	1,520,000
Captive Premium	1,188,700	1,188,700	1,188,700	1,188,700	1,188,700
Loss Reserves and Adjustments	(636,466)	(636,466)	(1,136,466)	(636,466)	(636,466)
Net Underwriting Income	552,234	552,234	52,234	552,234	552,234
Investment Income	10,597	16,880	20,637	23,794	28,846
Tax in Investment Income	(3,709)	(5,908)	(7,223)	(8,328)	(10,096)
Net Income After Tax	559,122	563,206	65,648	567,700	570,984
Dividend	-	-	-	-	2,326,661
Tax on Dividend (@ 15%)	-	-	-	-	348,999
Total Tax	1,523,709	1,525,908	1,527,223	1,528,328	1,879,095
Annual Differential Benefit / (Loss)	254,811	252,612	51,297	250,192	(100,575)
Cumulative Differential Benefit / (Loss)	254,811	507,423	558,720	808,912	708,337



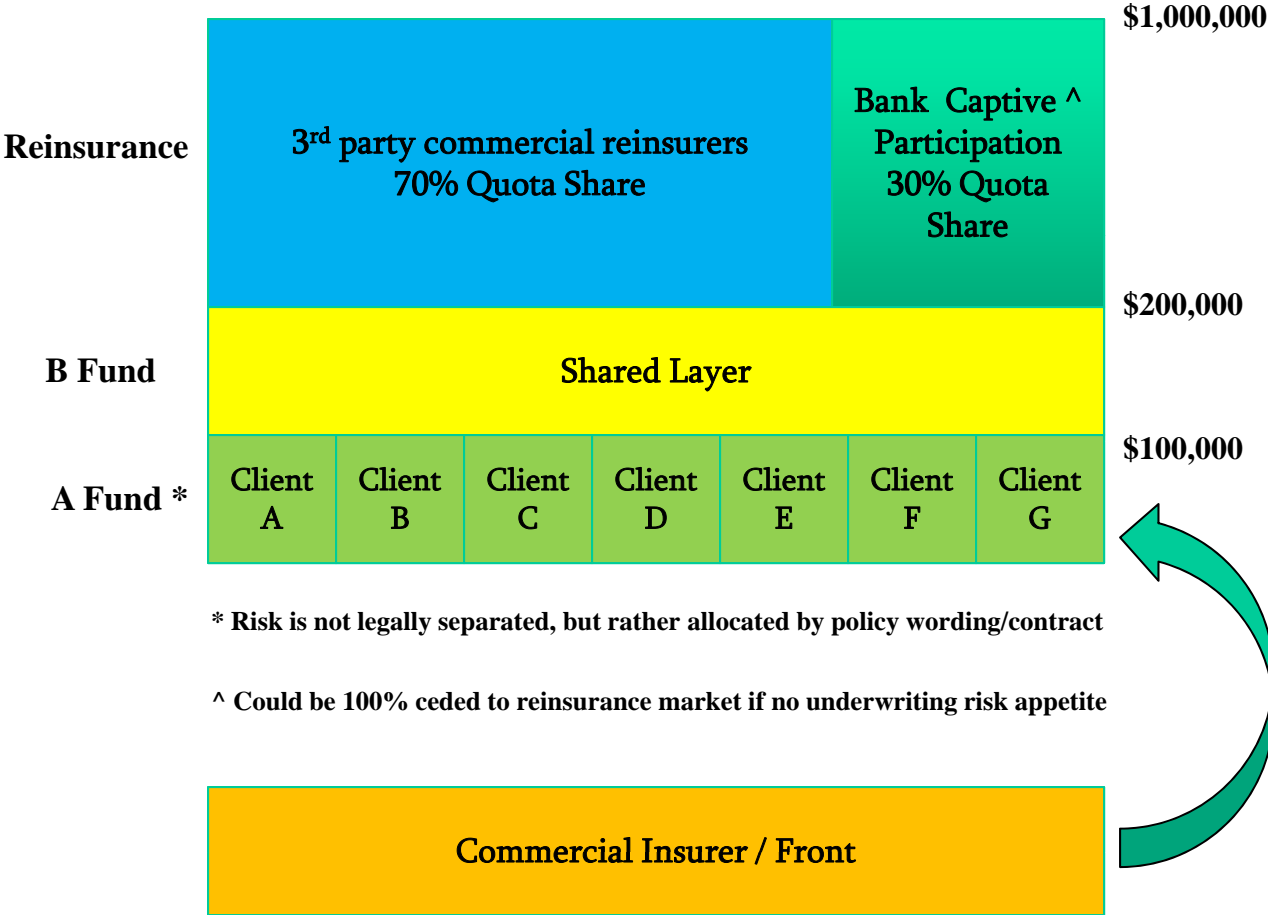
The above example is for illustration purposes and assumes that the captive is deemed an insurance company for tax purposes and makes a small insurance company election to be taxed on its investment income only. Actual results could differ significantly and should be reviewed with your tax advisor.

Third Party Captive – Underwriting

Bank Owned Agency/Brokerage Captive

- ▶ Participation in Established Agency Client Underwriting Portfolio
 - Partnership With Commercial Insurer
 - Traditional Predictable Lines of Business (Workers Compensation for Example)
 - Sharing in Working Layer Underwriting Profits
 - First Layer
 - Quota Share
 - Excess Layer

Third Party – Sample Structure



Third Party Captive – Fee Business

Explosion of Captive Usage by Small to Medium Size Organizations Has Opened New Revenue Opportunities to Financial Institution Owned Agencies and Banks

- ▶ Many Existing Agency/Brokerage Customers Are Potential Captive Opportunities
- ▶ Every Captive Opportunity is a Financial Cross Sale Opportunity
- ▶ Captive knowledge/Offering Provide Access to Potential New Customers

Third Party Captive – Fee Business

Tapping Customer Base – Captive Case Study

- ▶ Financial Institution Owned Insurance Agency
- ▶ Established Client Base of Profitable Mid-Size Organizations
 - \$50M+ in Revenues
 - Comfortable with Risk Retention
 - Clients Interested in:
 - Better Management of Retained Risk
 - Maximize Financial & Tax Efficiency of Retained Risk
 - Estate & Wealth Transfer Opportunities

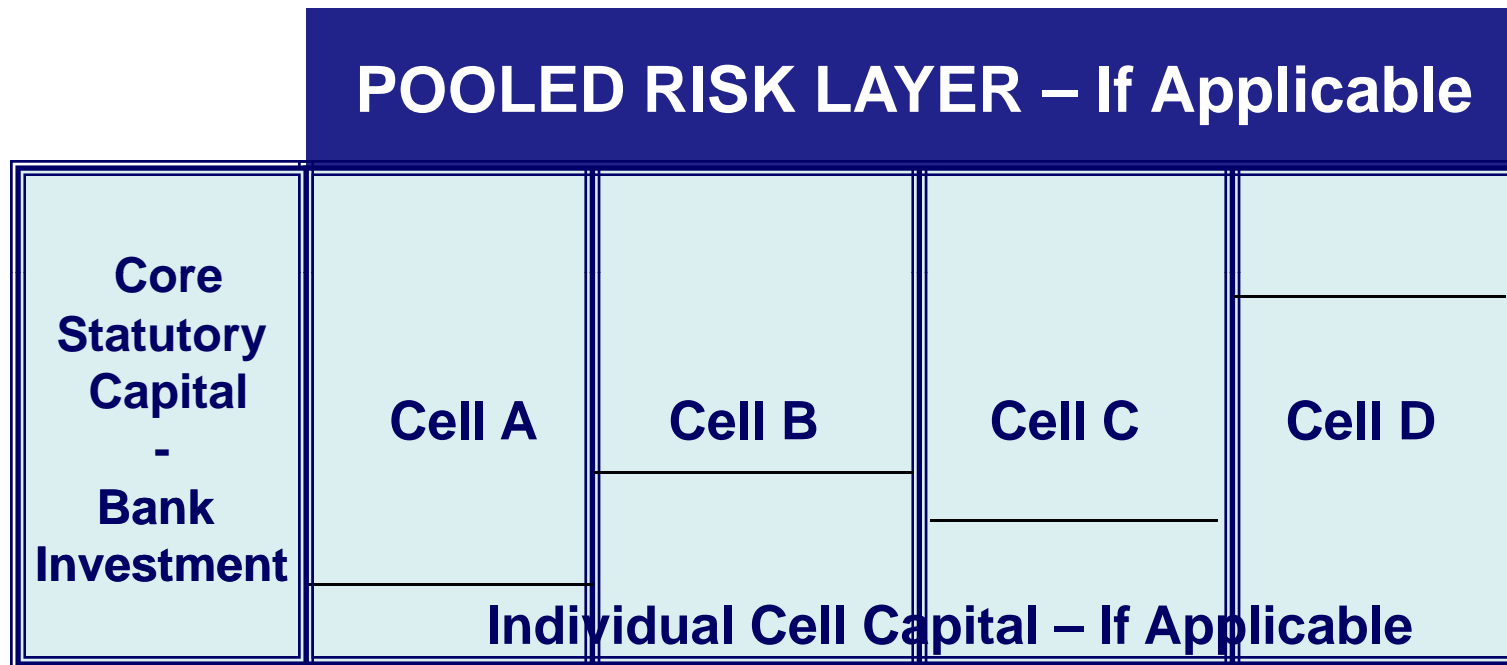
Third Party Captive – Fee Business

Tapping Customer Base – Captive Case Study

▶ Captive Solution

- Financial Institution Forms a Protected Cell Captive Insurer
- Agency Establishes Captive Structuring Team or Partners with Third Party Expert

Third Party Captive – Fee Business



Third Party Captive – Fee Business

Tapping Customer Base – Captive Case Study

▶ Potential Revenue Opportunities From Captive

- Bank Owned Agency
 - Program Structuring
 - Program Placement
 - Protected Cell Administration
 - Internal Cross Sale Opportunity
- Bank / Financial Institution
 - New Deposits
 - Letter of Credit and/or Trust Services
 - Investment Management
 - Internal Cross Sale Opportunity

Key Considerations

Key considerations for banks to discuss with legal counsel when forming a captive:

- ▶ Capital impact of paying premiums to the Bank owned captive
- ▶ Bank Holding Company vs. Financial Holding Company
- ▶ Arms length transaction between bank vs. holding company
- ▶ Regulatory approval of new captive entity vs. notification

Final Thoughts and Questions