

# MARSH

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## American Risk And Insurance Association Alternative Risk Finance Session Captive Insurance Update

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Marsh & McLennan Companies

# Objectives

- Dispel Myths
- Provide Background Information
- Review Why Captives Are Not Only a Hard Market Solution

# Introduction to Captives

- Risk Retention vs. Risk Financing
- Captives Defined
- Minimum Requirements
- Getting Started - The Captive Feasibility Process

# The Captive Feasibility Process

- Define Objectives
- Determine Advantages/Disadvantages
- Perform Actuarial Analysis
- Review Retention Levels
- Perform NPV/Cash Flow/Pro Formas
- Develop Program Structure
- Domicile Analysis
- Ownership Issues
- Tax Issues
- Implementation

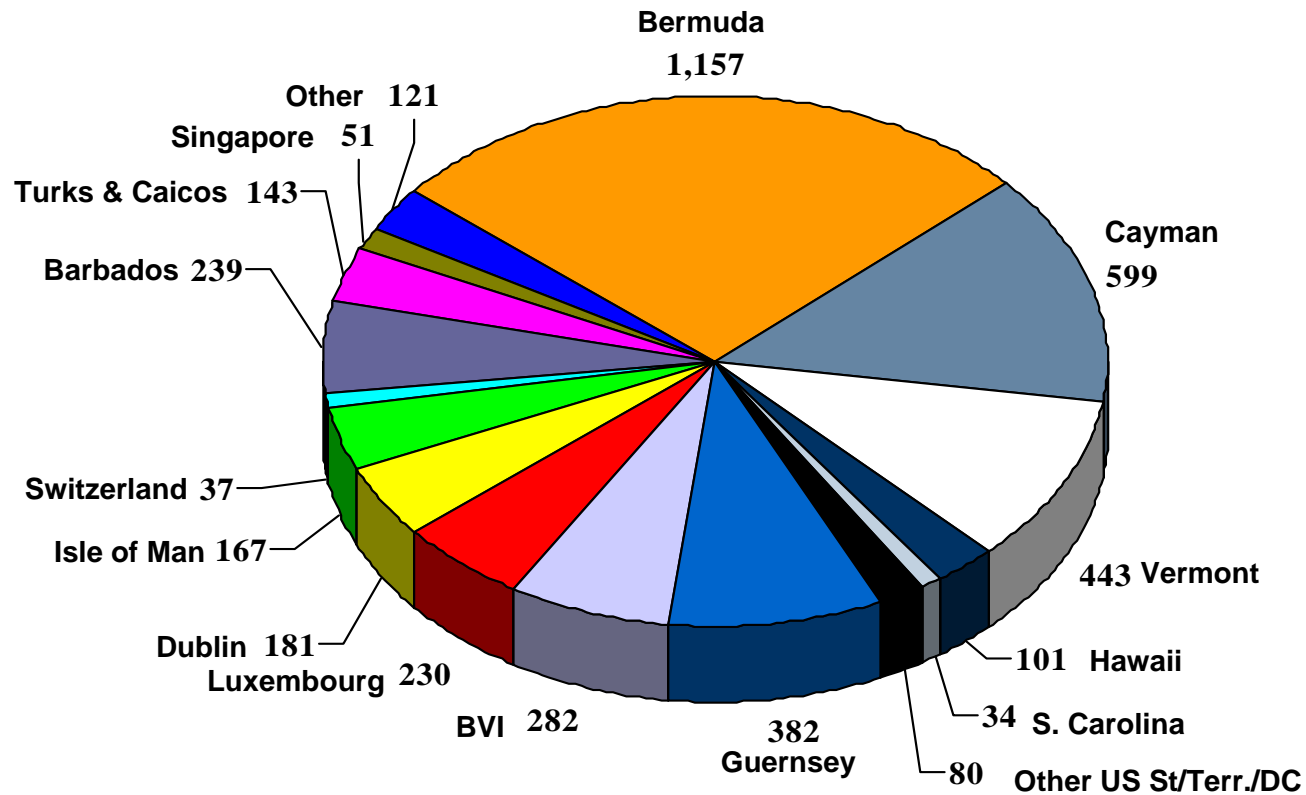
# Types of Captives

- Single Owner Captives
- Group Captives
  - Multiple Policyholder-Owned
  - Risk Retention Groups (U.S.)
  - Association-Owned Captives
- Rent-a-Captives/Protected Cell Company
- Branch Captives

# Domiciles

- Offshore
- Onshore
- Dublin
- Emerging Domiciles
- Differences: Premium, Excise Tax, Intercompany Loans, Third Party Business

# Active Captives by Domicile



(per Business Insurance – March 10, 2003)

# U.S. Insurance Taxation

- Risk Shifting & Distribution Must Be Present
- Traditional IRS Position
- Tax Update - New IRS Position

# U.S. Insurance Tax Issues

- Regular Corporations Can't Deduct Reserves
  - Only Insurance Companies Can
- What is the Difference?
- What is the Financial Benefit?

# Captive Utilization

## *Cost Savings*

- Income/Premium Taxes
- Direct Access to Reinsurers
- Negotiating Leverage
- Cash Flow - Underwriting Profit - Investment Income
- Evidence of Insurance

# Captive Utilization

## *Risk Funding*

- Uninsured Exposures
- Deductible Buydown - Hazard, Financial & Business Risk
- Investment Income - Accrues To Captive
- Portfolio Transfers
- Visibility

# Captive Utilization

## *Profit Center*

- Customer Coverages
- Joint Ventures
- Suppliers/Distributors
- Employee Benefits
- Employee Personal Lines - Homeowners, Automobile, Umbrella

# What is New?

- **Captives and TRIA**

# Background

- Three year window ending 12/31/05
- Applicable to U.S. domiciled captives only
- Insurance must be written on a direct basis
- Intent of the Act

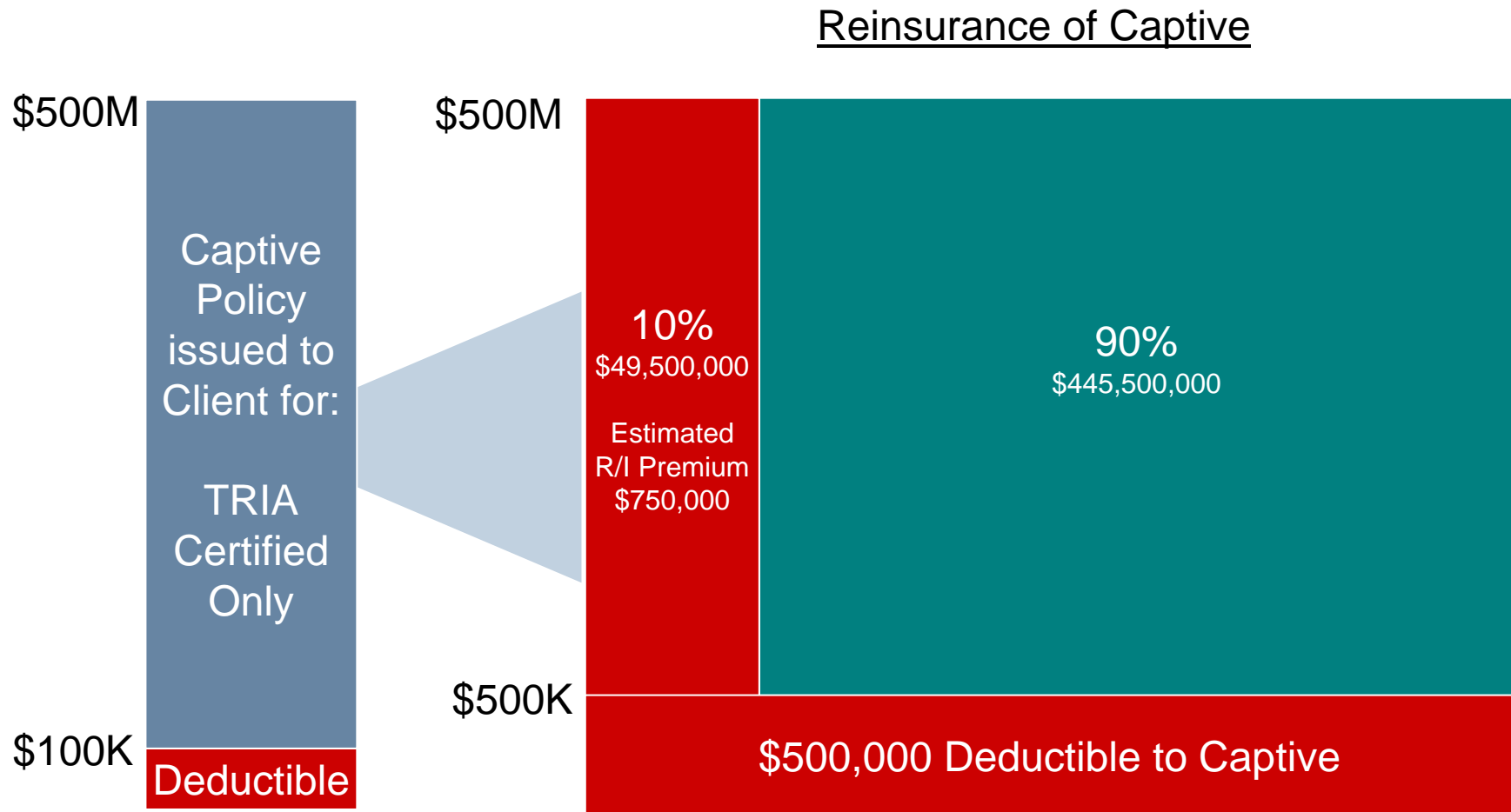
# Coverage and Pricing Issues

- Property exposures are generating the most interest
- Only applies to foreign sponsored events occurring in the U.S.
- Pricing should be market based

# How it Works

- Deductibles based on written property and casualty premium
- Deductibles will increase from 7% in 2003 to 10% in 2004 to 15% in 2005
- Coinsurance of 10% of loss excess of deductible
- Surcharge of up to 3% of property & casualty premium in the event of a covered terrorist act.

# Alternative Terrorism Solution Accessing TRIA through a US captive



Example: \$5,000,000 Premium

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Includes Nuclear, Biological and Chemical Certified Acts, however, captive retains 10% quota share for these risks

# What is New?

- **Captives and Employee Benefits**

# Background

- Self dealing generally prohibited-exemptions tough to obtain
- 12 year old revenue ruling define benefits as unrelated risk
- Four recent rulings provide guidance for DOL approval
  - Columbia Energy
  - Archer Daniels Midland
  - International Paper
  - SCA (Svenska Cellulosa Aktiebolget)

# How to Qualify

- Improvement to benefits
- US captive or US branch of foreign captive
- Arms length pricing
- Fronted by A rated carrier
- Fiduciary
- Actuary

# Which Benefits Work?

- Group term life
- Disability
- Probably *not* Health
- Retiree Benefits?

# Why Do It?

- Diversification of risk
- Source of related business - third party business
- Integration of absence management

# Conclusion