



HYLANT

HYLANT PRESENTS |

Alternative Risk Solutions – Is a Captive an Option?

NOVEMBER 2020



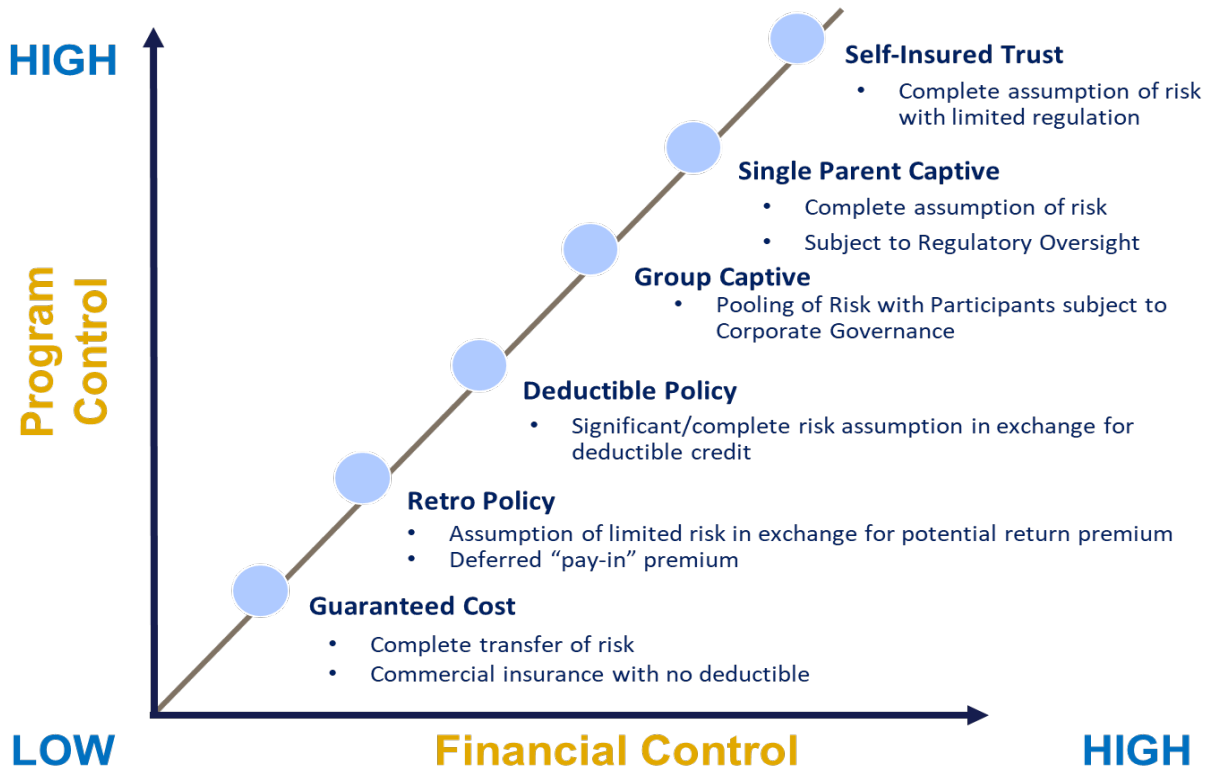
GLOBAL
Captive Solutions



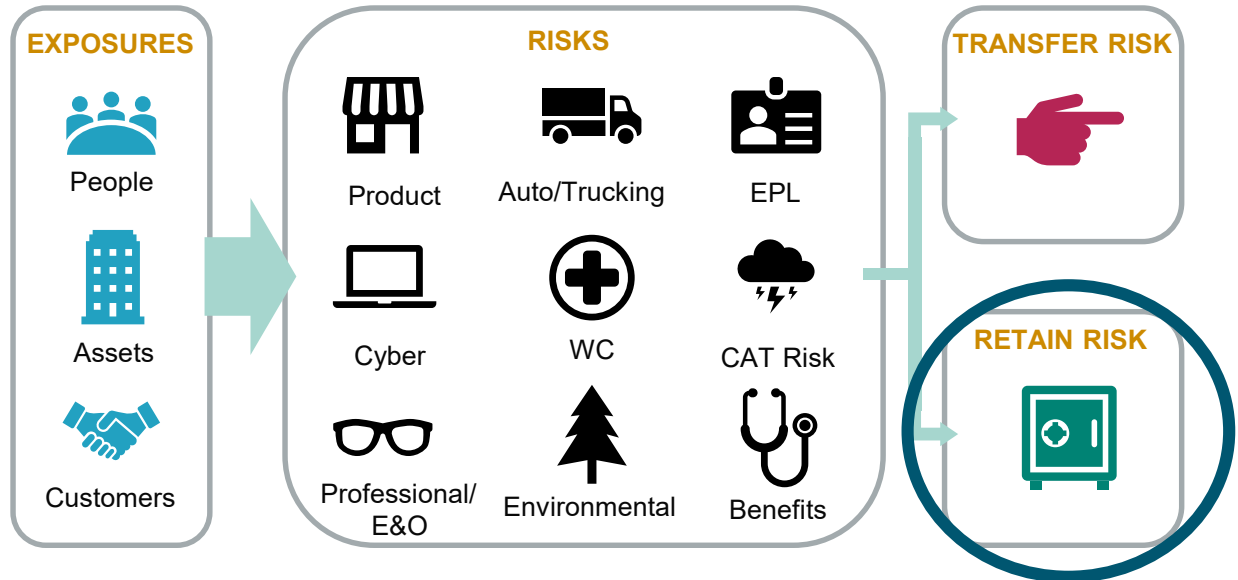
Risk Appetite



Risk Appetite Spectrum



Risk Transfer v. Risk Retention



Determining your Risk Tolerance

Measured as a % of :

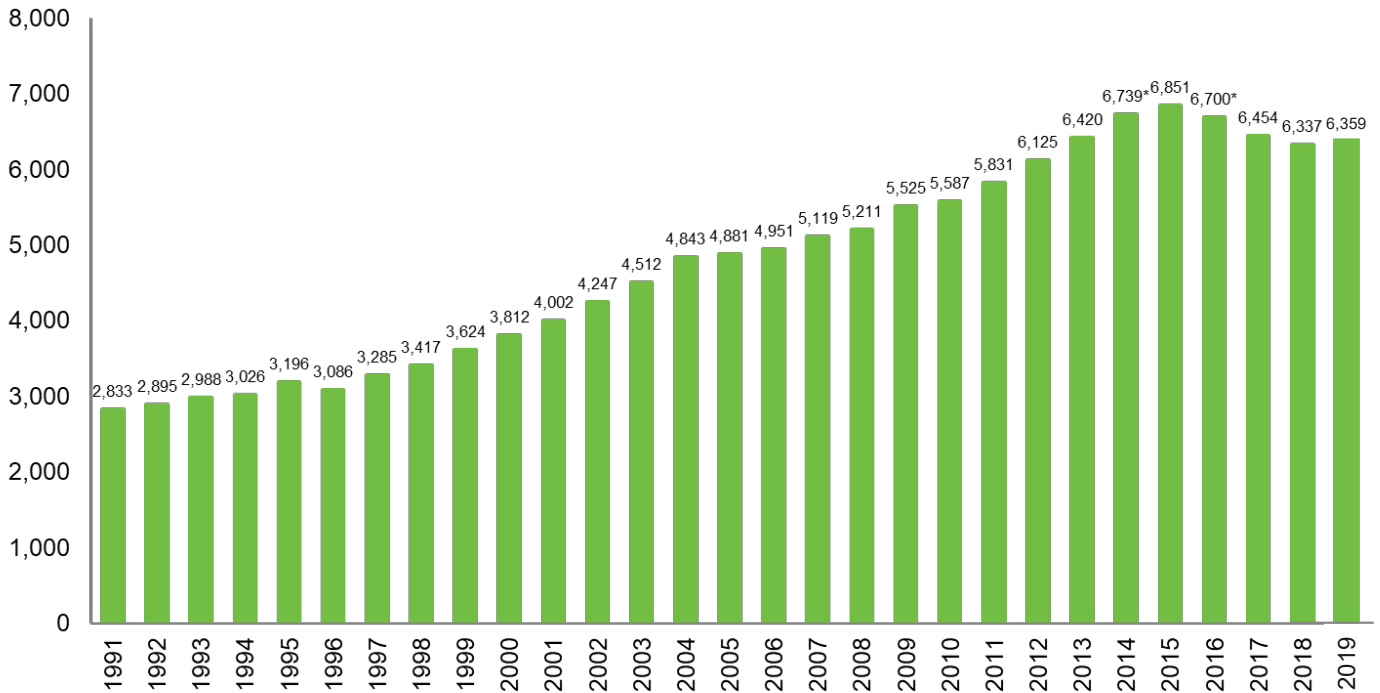
- ✓ Retained Earnings
- ✓ EBITDA
- ✓ Net Cash Flow
- ✓ Unique Industry/Organization KPIs



The ultimate decision is tempered by individual company philosophy, risk tolerance, business development goals, shareholder expectations, etc.



Captive Industry Growth



Source: Business Insurance, 2019 Captive Managers & Domiciles, Rankings + Directory: 8

*2017 is restated. (1994 to present), Source: Insurance Information Institute (1991-1993)



Captive Basics

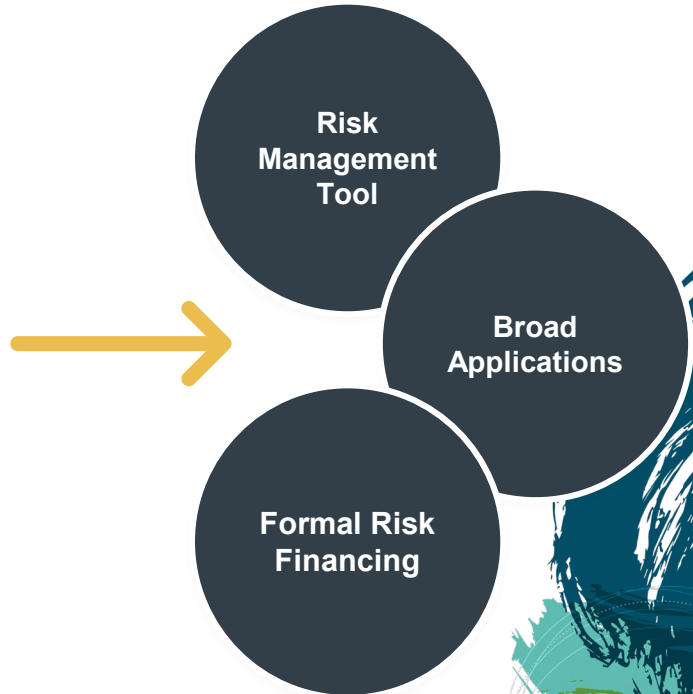


What is a Captive?

A **licensed insurance company** owned and controlled by those it insures

Insures or reinsures the risk of its parent(s) or affiliated companies

Formalized mechanism to finance **self-insured risk**



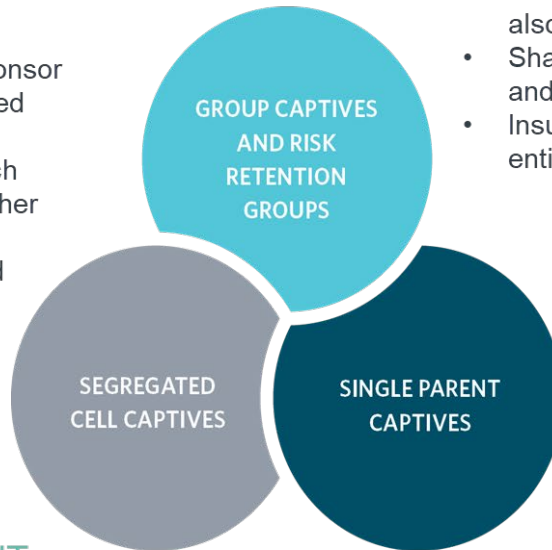
Types of Captives

CELL CAPTIVE

- Segregated/protected or incorporated cell
- Formed by a third party sponsor who “rents” cells to unrelated companies
- Assets and liabilities of each cell are segregated from other cells
- Typically lower start-up and frictional costs than SPCs
- Each cell owner is typically required to capitalize that particular cell

SINGLE PARENT

- Owned by one company
- Insures or reinsures the risk of its parent, subsidiaries, or chosen unaffiliated parties



GROUP/ASSOCIATION

- Owned by multiple companies who are also shareholders
- Sharing of un-controlled risk, liabilities, and profits
- Insures or re-insures the risk of the entire group

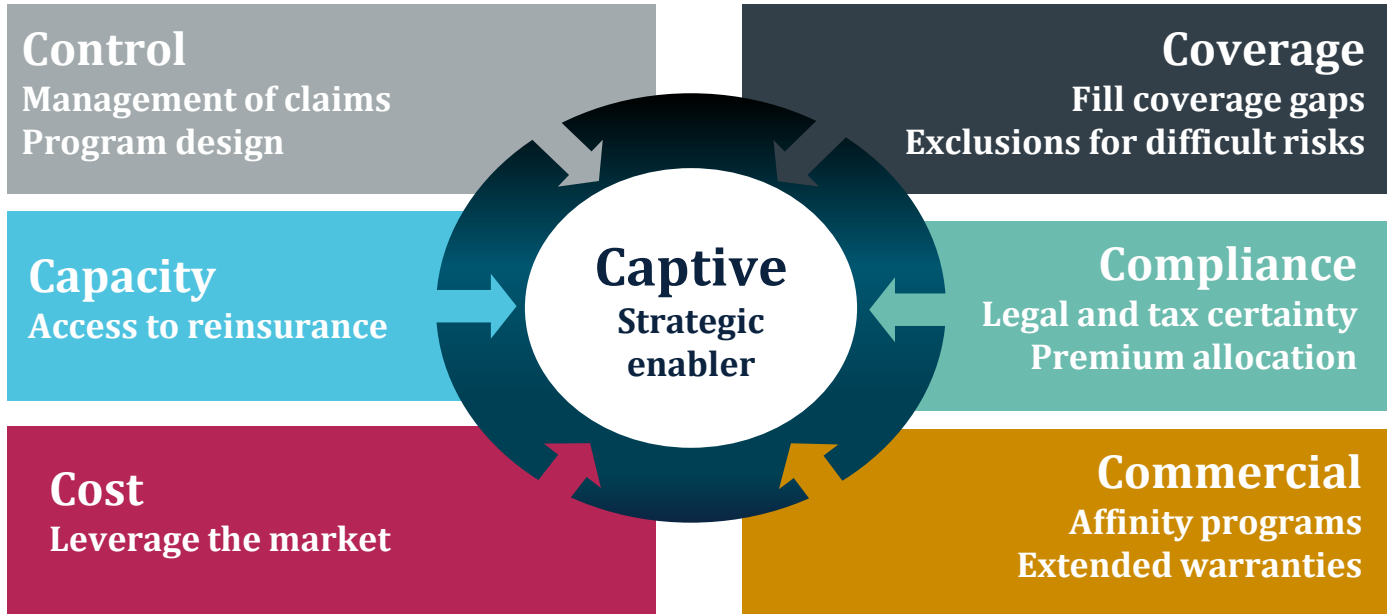
RISK RETENTION GROUP

- Specific type of group captive
- Regulated under U.S. federal legislation
- Licensed in one state and able to operate in all 50 states on a registered basis
- Can only write liability lines of risk – no workers compensation or property



Captive – Strategic Value

Why are Captives Formed?





Sample Types of Risks

Traditional Lines

- Workers Comp.
- Auto (Liab & PD)
- General Liability
- Professional Liability
 - Property
- CAT Risks (Quake, Flood, Wind)
 - Environmental
- Directors & Officers
- Employment Practices

- Voluntary Benefits
- Extended Warranty
 - Supply Chain
- Suppliers
- Vendors
- Customers

Third-Party Risk

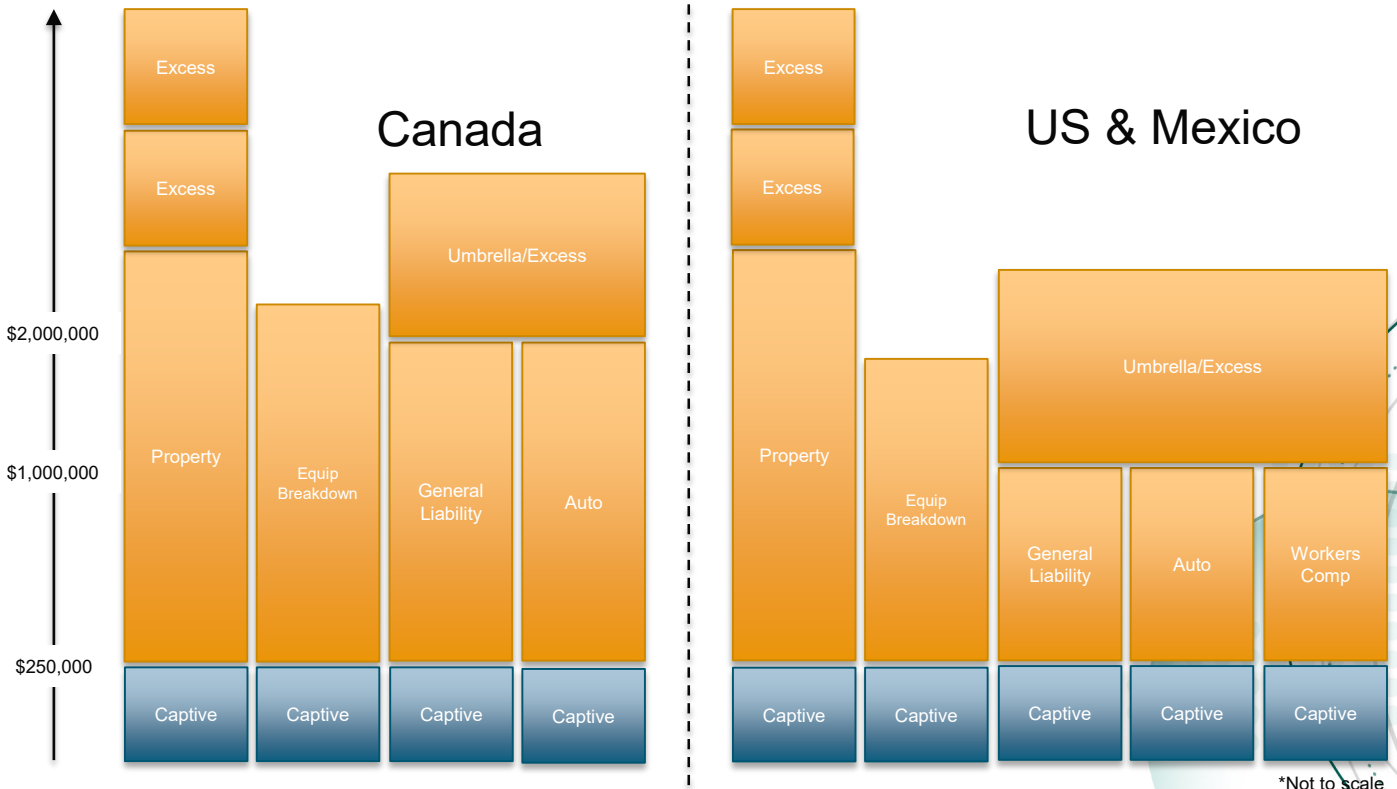
Emerging Lines

- Warranty Risk
- Construction Risks
- Regulatory Liability
- Network/Cyber Security
 - Wage & Hour
- Reputational Risk
- Executive Risk
 - Benefits



Sample Captive Program

Property & Casualty Program with Captive

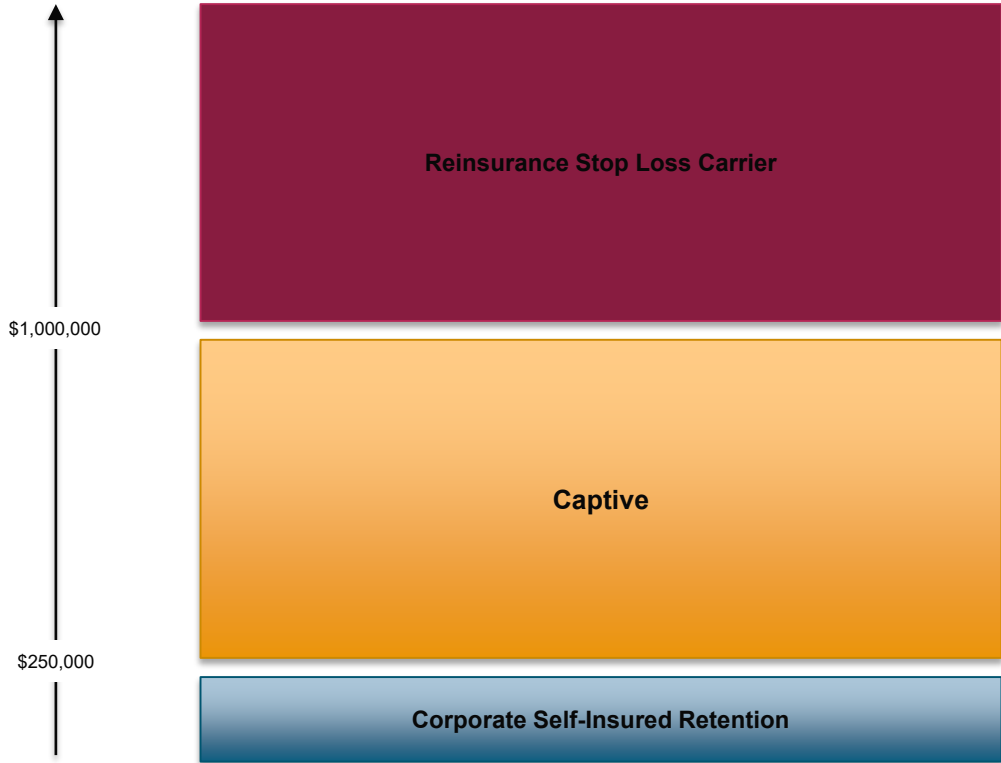


*Not to scale.



Sample Captive Program

Medical Stop Loss Program with Captive



*Not to scale.

Why Consider a Captive?



Financial

- Potential short- and long-term savings
- Financial reward for being better-than-average
- Capture investment returns
- Remove traditional insurer's profit loading



Control

- Ability to better manage premium volatility from year-to-year
- Power to reduce costs over time by controlling losses
- Be rewarded for good loss prevention and claims management



Flexibility

- Ability to craft coverages to meet specific insured's needs
- Options for customized value-added services
- Insulated from market conditions; address insured needs, not the insurance market



Considerations



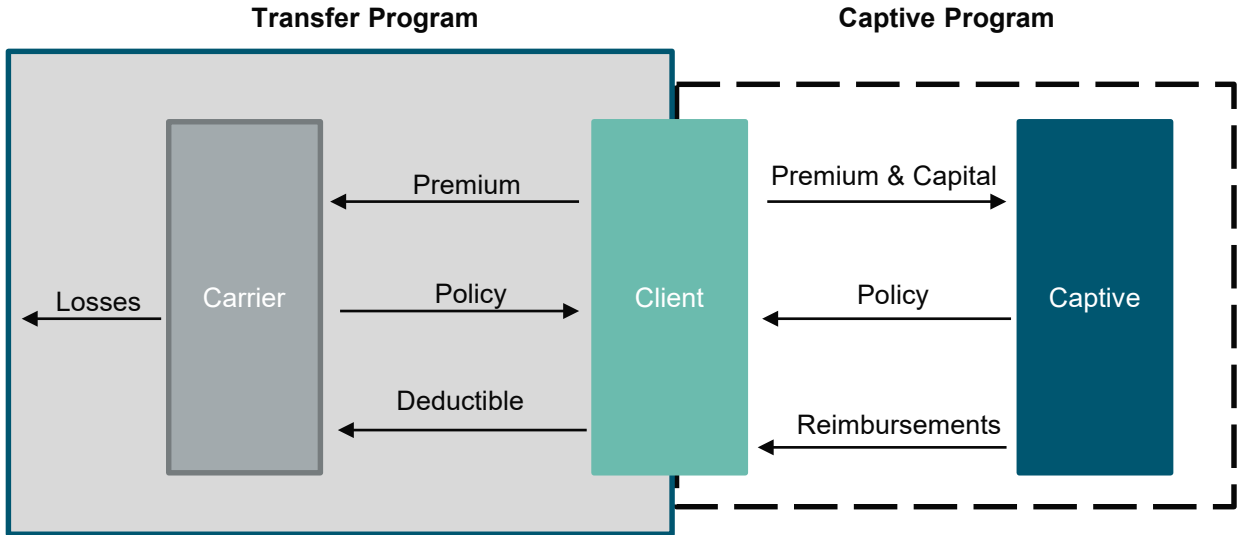
- Incurring unexpectedly large losses
- Compliance issues
- Meeting and maintaining capital requirements
- Competing uses for available capital
- Accessing capital for competing needs
- Distributing profits
- Winding down program
- Restrictions on selling or transferring ownership
- Focus and commitment must be long term
- Overcoming the learning curve



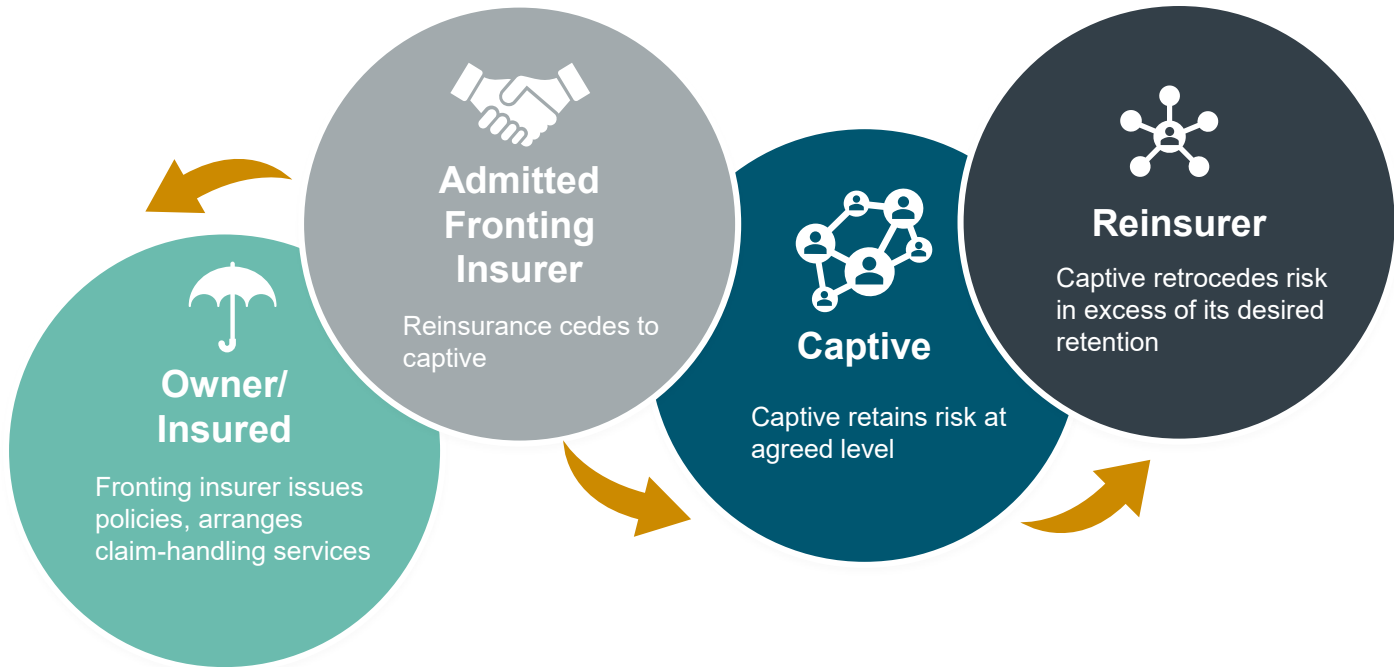
Captive Program Structures



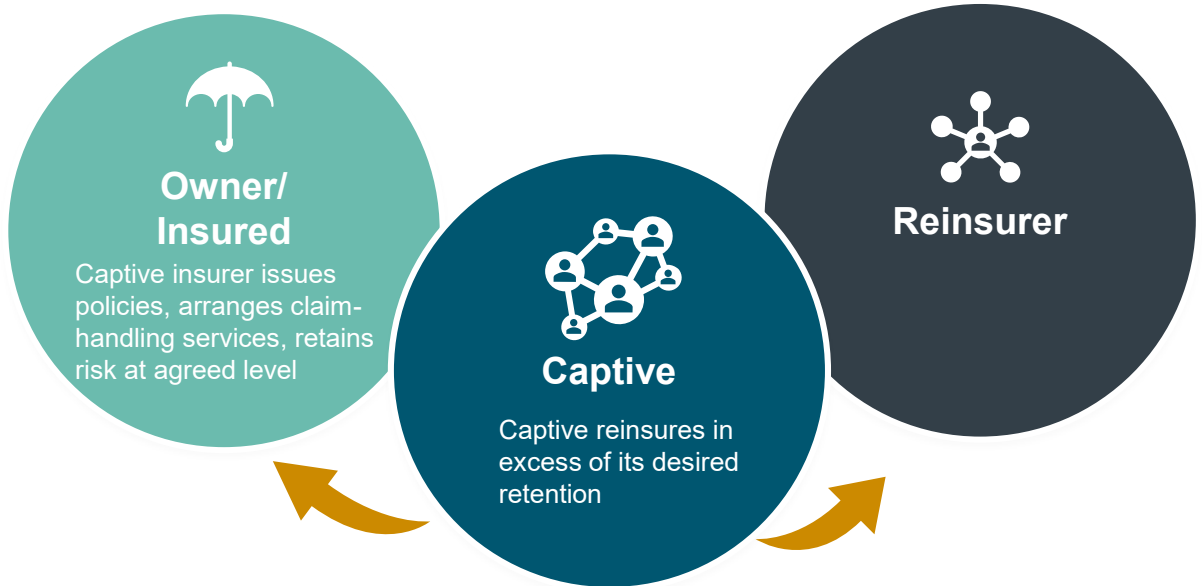
Deductible Buy-back Captive



Fronted Reinsurance Captive



Direct-Issue Captive





Tax Considerations



US Federal Income Tax – Defining Insurance

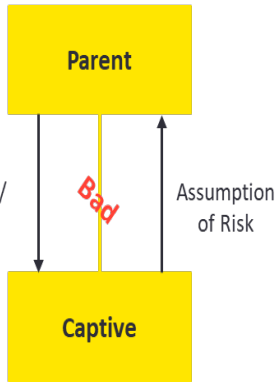
- Existence of “insurance risk” - not investment or business risks
- Regulated insurance company
- “Risk shifting” - shift financial risk to the captive with no parental guarantees
- Existence of risk transfer
- “Risk distribution” - appropriately shift the risks among a sufficient number of insureds



How to qualify as an Insurance Company for tax purposes

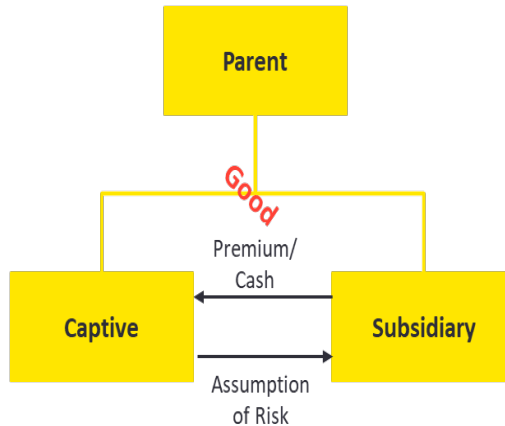
Alternative One

Parent/Subsidiary



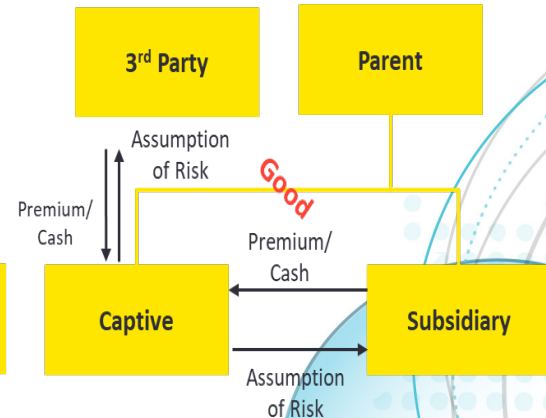
Alternative Two

Brother/Sister



Alternative Three

Brother/Sister & 3rd party





Insurance Taxation

Key Variables

Insurance Company for Federal Income Tax Purposes

- Premium payments are tax deductible
- Captive recognizes income
- Captive recognizes deduction for loss reserves on discounted basis
- Position supported through precedent setting case law

Self Insurance Model – Deposit Accounting

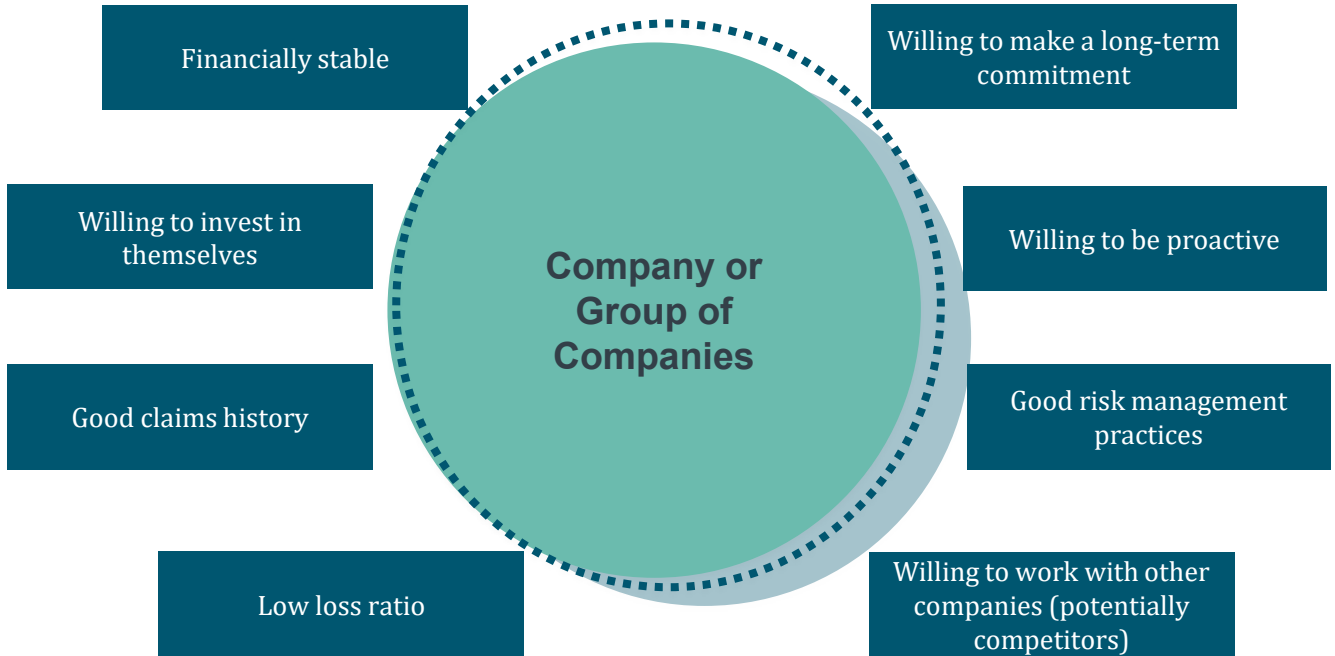
- Payments are non-tax deductible
- No tax deduction for loss reserves
- Claims are tax deductible when paid



Captive Evaluation



Who Should Consider a Captive?



Captive Evaluation Process



• 01 •

Feasibility Analysis



• 02 •

Implementation



• 03 •

Captive Management

Feasibility Analysis

Evaluate

- Exposures
- Coverage needs
- Cash-flow requirements
- Current program

Analysis

- Domicile analysis
- Ownership and structure analysis
- Actuarial analysis

Typical Timeline: 8-12 weeks



01

Considerations

- Investment considerations
- Regulatory and legal considerations
- Federal and state tax considerations
- Cost considerations

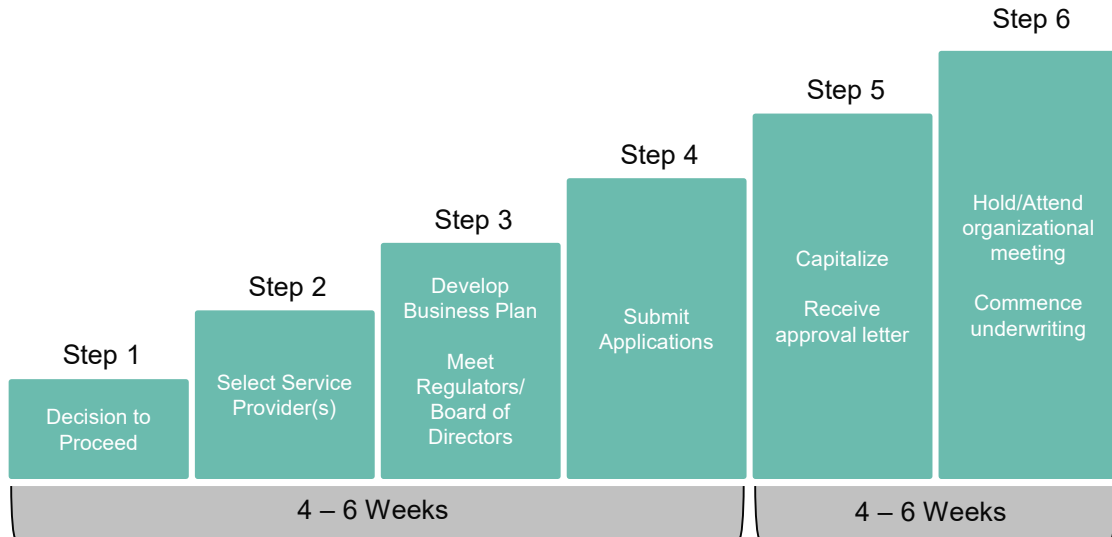
Implementation plan for execution



Implementation



• 02 •

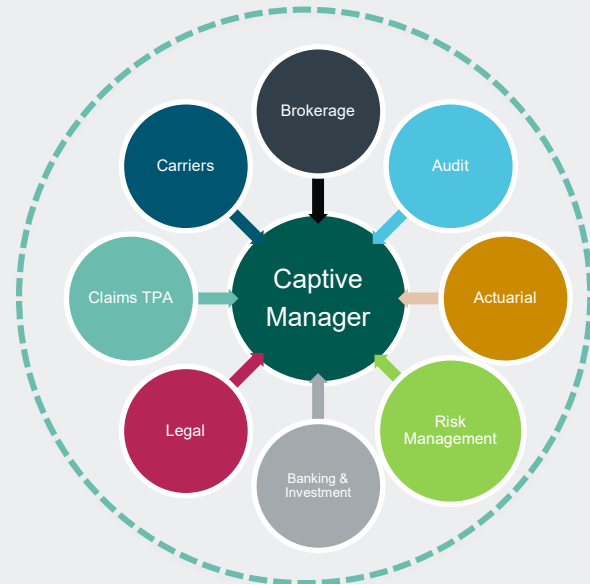


Management & Operations

• 03 •

- Coordination of all service providers
- Liaison with domicile regulators
- Coordinate and handle board meetings
- Coordinate all renewal processes
- Ongoing financial, underwriting and corporate administration of captive

From **start to finish**, we work tirelessly to guide you through the captive process.





Cost Considerations



Feasibility & Implementation Costs – Single Parent

Feasibility Work Performed	Low End	High End
Hylant Captive Consulting	\$40,000	\$65,000
Legal and/or Tax	TBD	TBD
Actuarial	\$10,000	\$20,000

Implementation Work Performed	Low End	High End
Hylant Captive Consulting	\$10,000	\$20,000
Legal and/or Tax	\$3,000	\$8,000
Miscellaneous Expenses	\$500	\$5,000
Domicile Fees	\$500	\$12,000



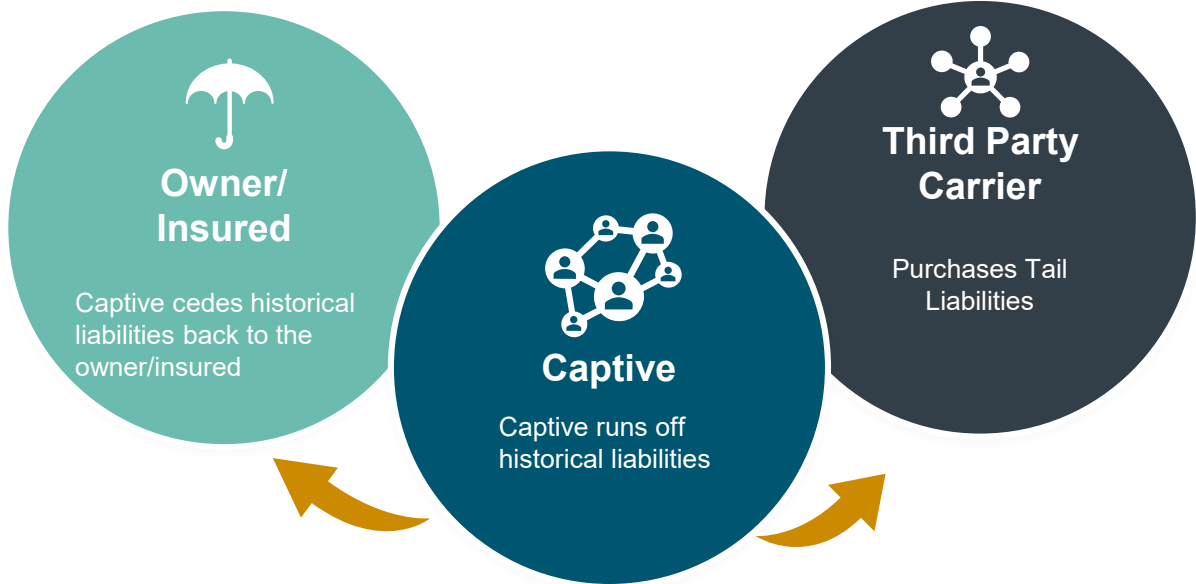
Captive Operating Costs – Single Parent

Captive Services	Low End	High End
Hylant Captive Management	\$50,000	\$100,000
Legal and/or Tax	\$1,000	\$3,000
Audit	\$15,000	\$25,000
Actuarial	\$10,000	\$20,000
Banking, Travel and Miscellaneous Expenses	\$500	\$10,000
Domicile Fees	\$500	\$12,000
TPA Services	TBD	TBD



Exit Strategies

Exit Strategies



After one of the options is completed the captive can be shut down and surrender the certificate of authority.



Is a Captive the Right Solution?