

Introduction to Small Captives

(831b Election)

Minto Law Group, LLC

&

The HDH Group

Captive Dept.

U.S. Steel Tower

Pittsburgh, PA. 15219

What are Captive Insurance Companies?

A captive insurance company (“captive”) is an insurance company organized primarily for the purpose of insuring or reinsuring the liabilities of the owner.

Reasons for Forming a Captive Insurance Company

1. A client who wants to take advantage of their favorable underwriting experience;
2. A client who needs coverage that is otherwise unavailable;
3. Obtaining insurance at a lower cost – insurance overhead and profit often account for 45% of premium;
4. Creating a new profit center by writing unrelated or currently uninsured risks for profit;
5. Increase cash flow and investment income through tax and insurance expense savings;
6. Underwriting advantages –knowledge of business and experience rating;
7. Potential Estate & Tax advantages;

Who is the ideal captive candidate?

The ideal client is an individual business owner whose business has taxable income in excess of \$750,000 with insurable and identifiable risks, who has available cash flow to fund insurance premiums of \$450,000 per year. The characteristics of the ideal client include:

- *Privately held*
- *Less than 5 shareholders*
- *Steady profits over 3 year period*
- *Adequate amount of uninsured risk within your business*
- *Entrepreneurial*
- *Willing to take a measured degree of insurance risk*

Captive Cost / Benefit Analysis

YEAR ONE

Annual premium: \$1,200,000
 Return on investment 8%

With Captive

Description	Year 1
Beginning value	-0-
Premium Payment	\$ 1,200,000
Legal fee	(\$25,000)
Reinsurance expense	(\$30,000)
Administration fees	(\$60,780)
Subtotal	\$ 1,084,220
Return on investment	\$90,000
Total value of account	\$ 1,174,220

Without captive

Description	
Add'l Co profit	\$1,200,000
Taxes at 40%	(480,000)
Net after tax	\$ 720,000
Return on investment	\$57,600
Total	\$ 777,600

Comparison

Value with Captive	\$1,174,000
Value without Captive	(\$777,600)
Captive savings in first year alone	\$ 396,620

Sample Captive Illustration

YEAR TWO

Annual premium: \$1,200,000

Return on investment 8%

Captive

Description Year 2 & thereafter

Beginning value	-0-
Premium Payment	\$ 1,200,000
Set up fee	(0)
Reinsurance expense	(\$30,000)
Annual fees	____(\$53,000)
Subtotal	\$ 1,117,000
Return on investment	____\$90,000
Total value of account	\$ 1,207,000

Without captive

Description

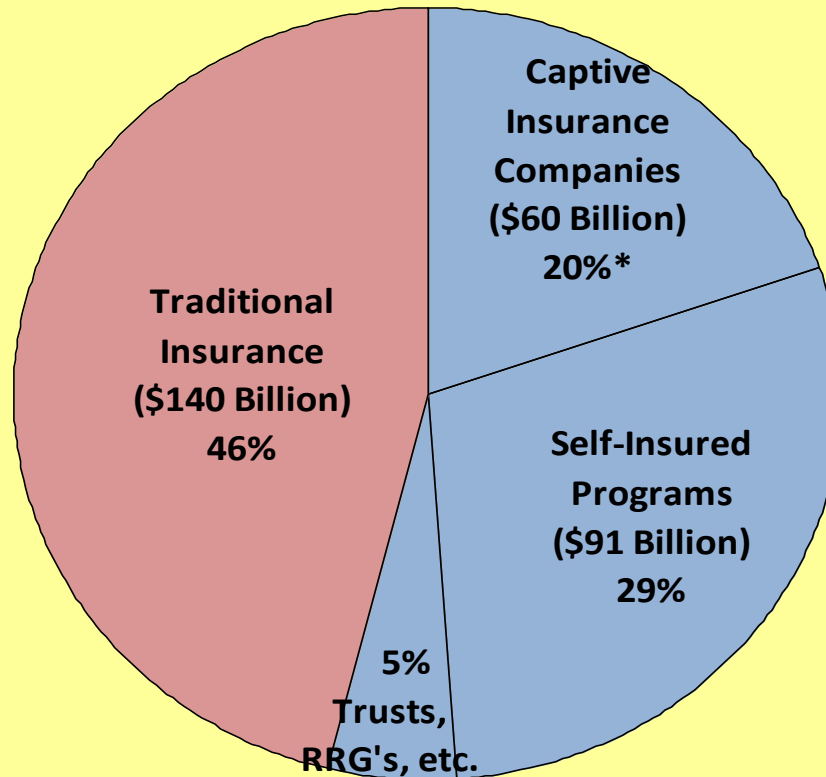
Add'l Co profit	\$1,200,000
Taxes at 40%	____(\$480,000)
Net after tax	\$ 720,000
Return on investment	____\$ 57,600
Total	\$777,600

Comparison

Value with Captive	\$1,207,000
Value without Captive	____\$ (777,600)
Captive savings each year	\$ 429,400

Captives are Very Common

U.S. Commercial Insurance Marketplace



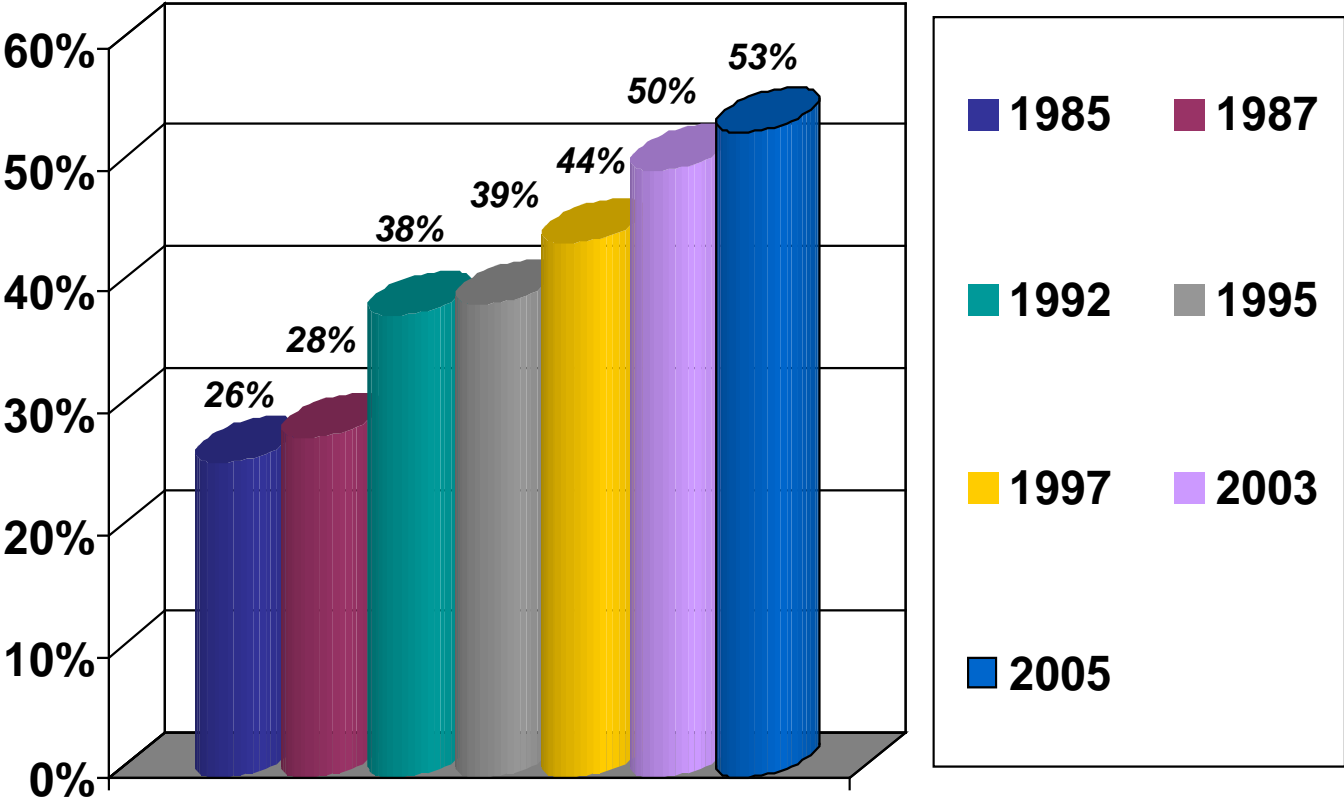
Source: A.M. Best

* Captive Statistics do not include foreign domiciles such as Dublin, Guernsey

U.S. Companies Insured by the Alternative Risk Market

2007

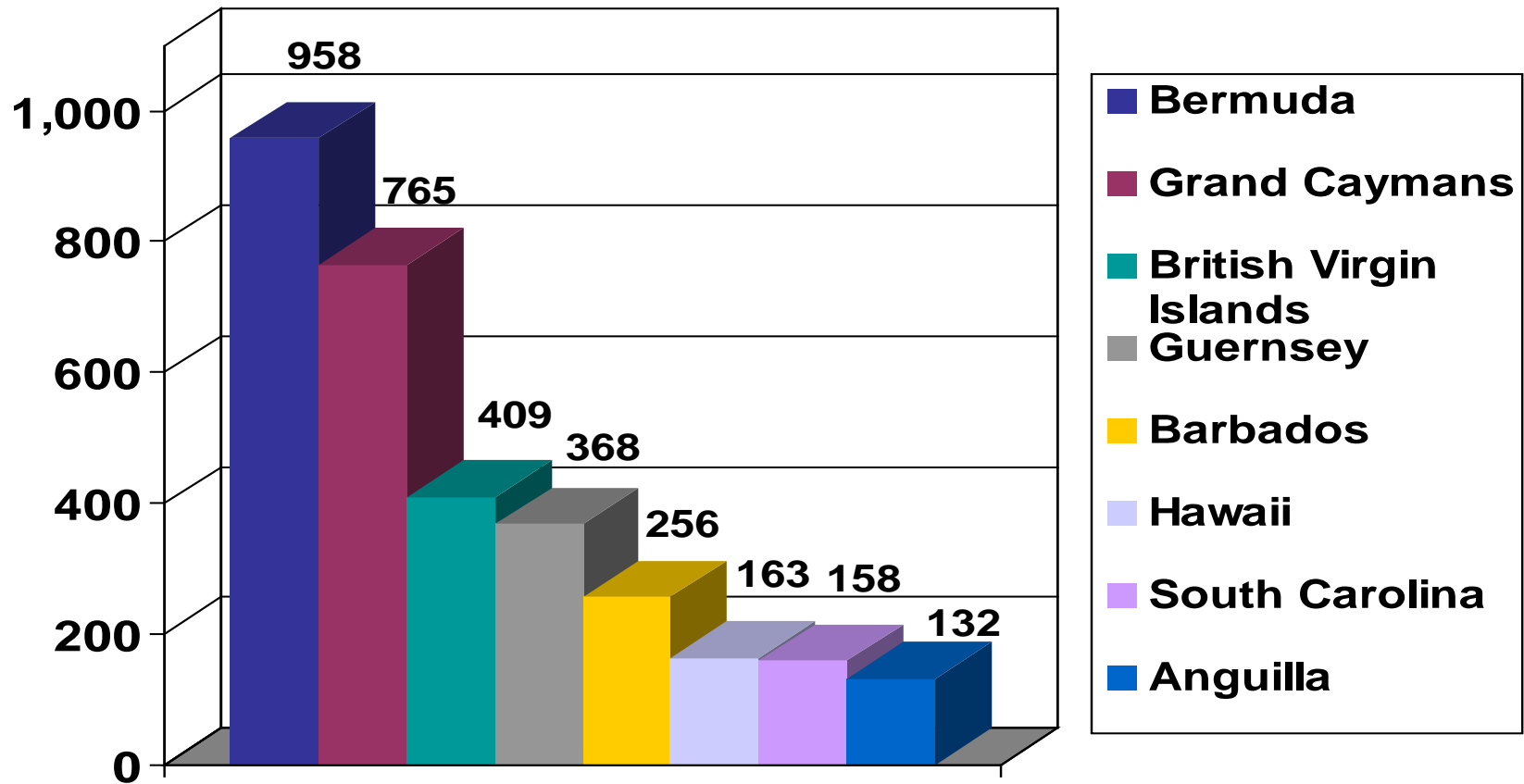
Source: A.M. Best / Captive Insurance Co. Reports, April 2007



Domicile Comparison

2008

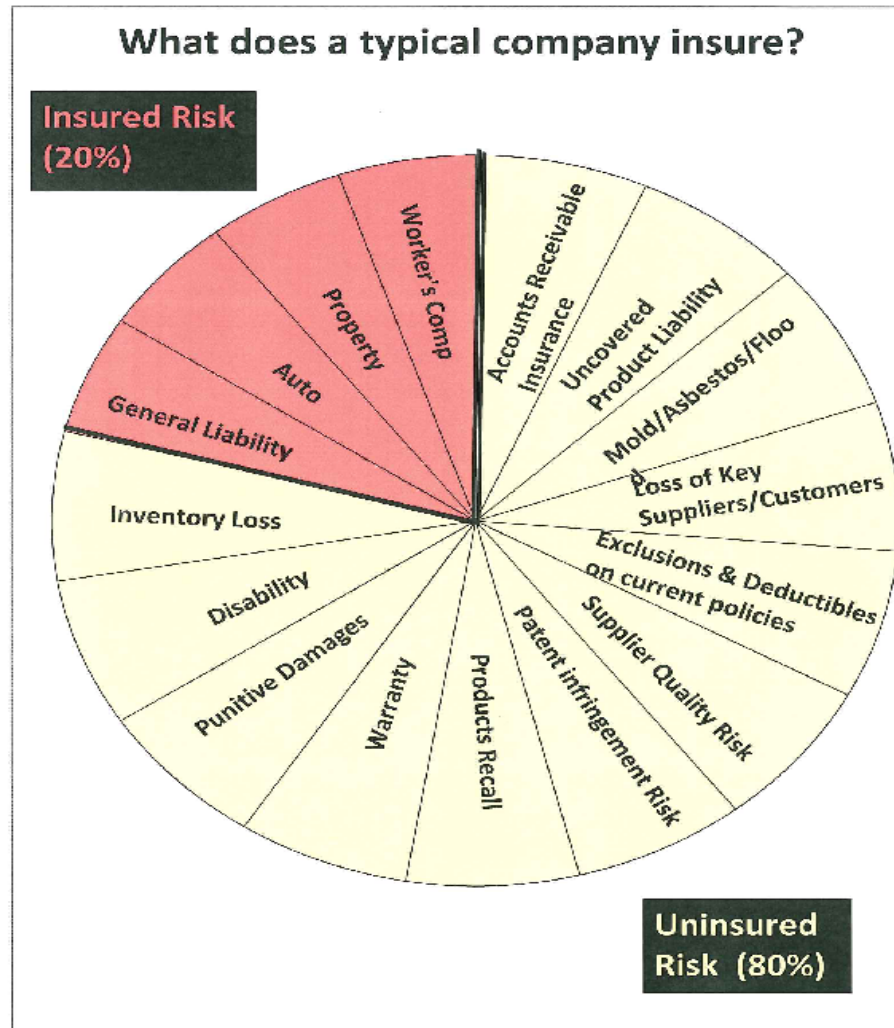
Source: Captive Insurance Co. Reports, May 2008



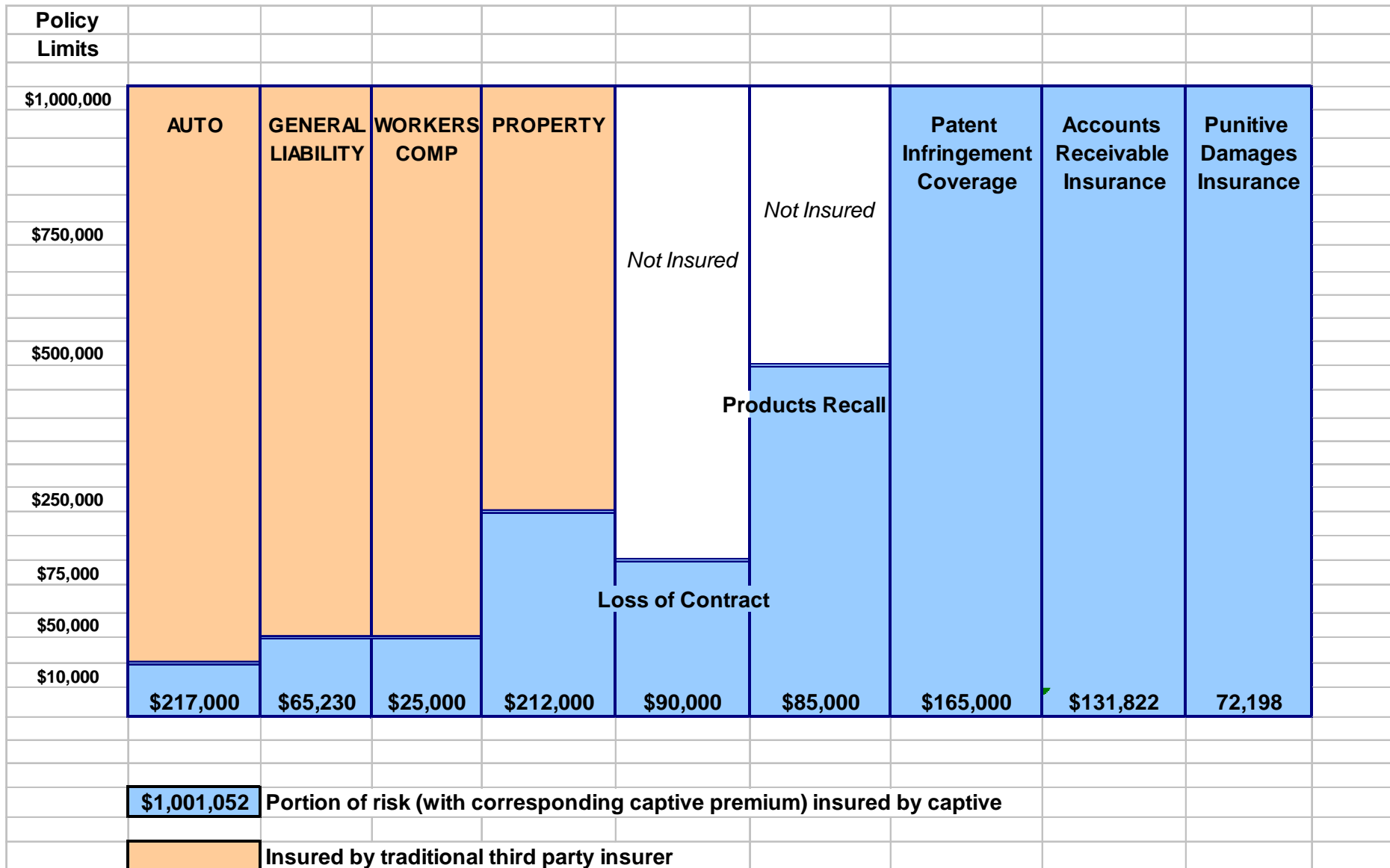
What Risks Would Your Captive Typically Insure?

Over 80% of a typical company's risk is uninsured. The remaining risk can be put in a captive.

-Conning Research



Sample Program Structure



- ***“An Insurance Company wishing to be licensed in the domicile must show that those persons who control its affairs are competent, with evidence of relevant ability, integrity and experience in the field of captive insurance”***
 - *Taken from the insurance act of an offshore domicile. All domiciles have similar wording*

The HDH Captive Dept.

- Over 200 captive clients
- 2 Risk Retention Groups
- 3 Self Insured Trusts
- Captives relationships in seven different domiciles (onshore & offshore)
- \$21 million in premium managed *(as of 12/31/07)*
- Structures include rental captives, single parent captives, S.P.C. captives, association captives, risk retention groups & others
- Industries include pharmaceuticals, trucking, restaurants, banks, stock brokers, nonprofits, healthcare, contractors, reform schools, physicians, etc.
- Four dedicated employees specializing in captives