

Captive Insurance

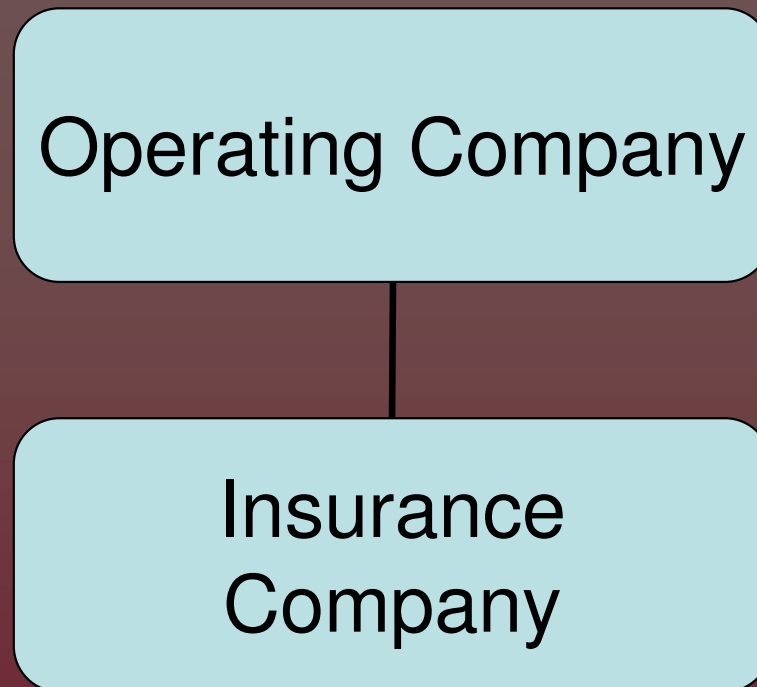
Some Definitions

Captive Insurance

Unity of ownership or interest
between insured and the insurer

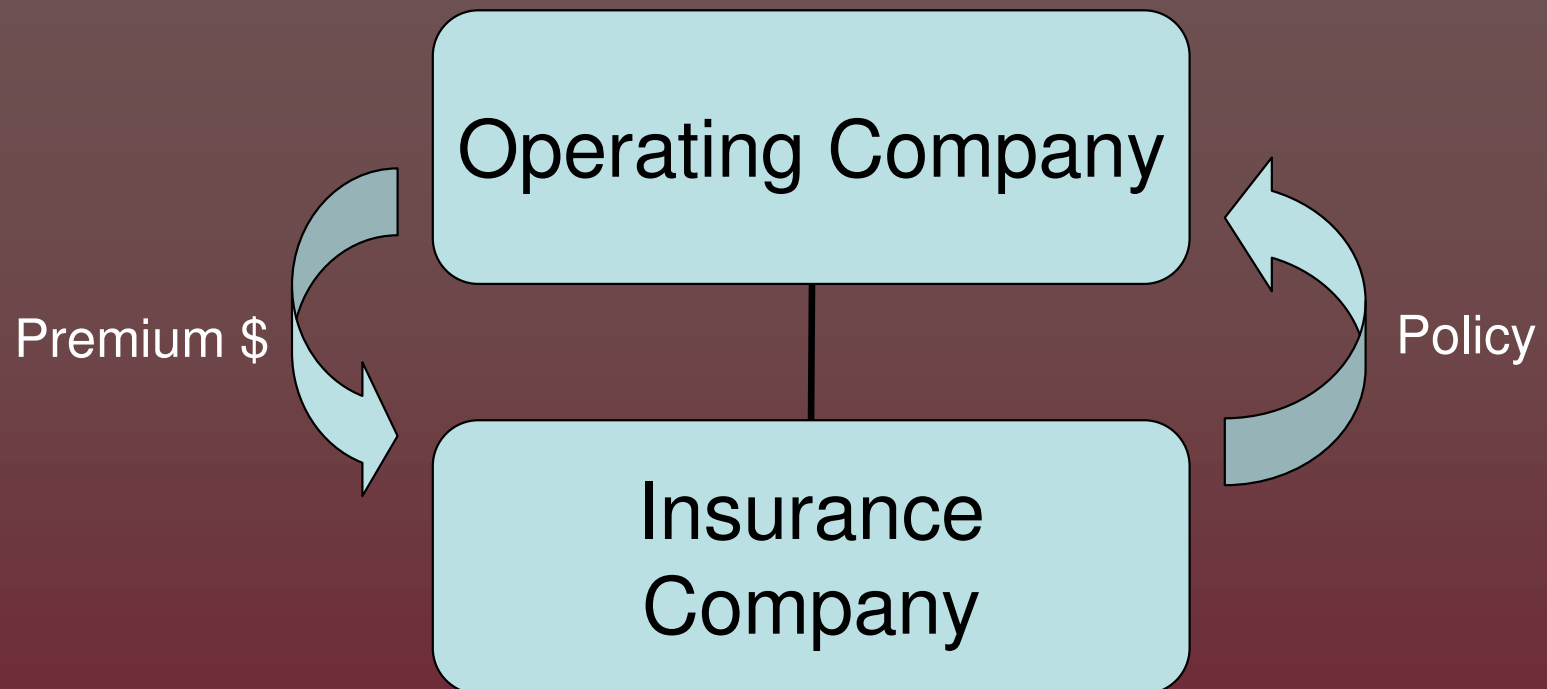
Definitions

- Single Parent:



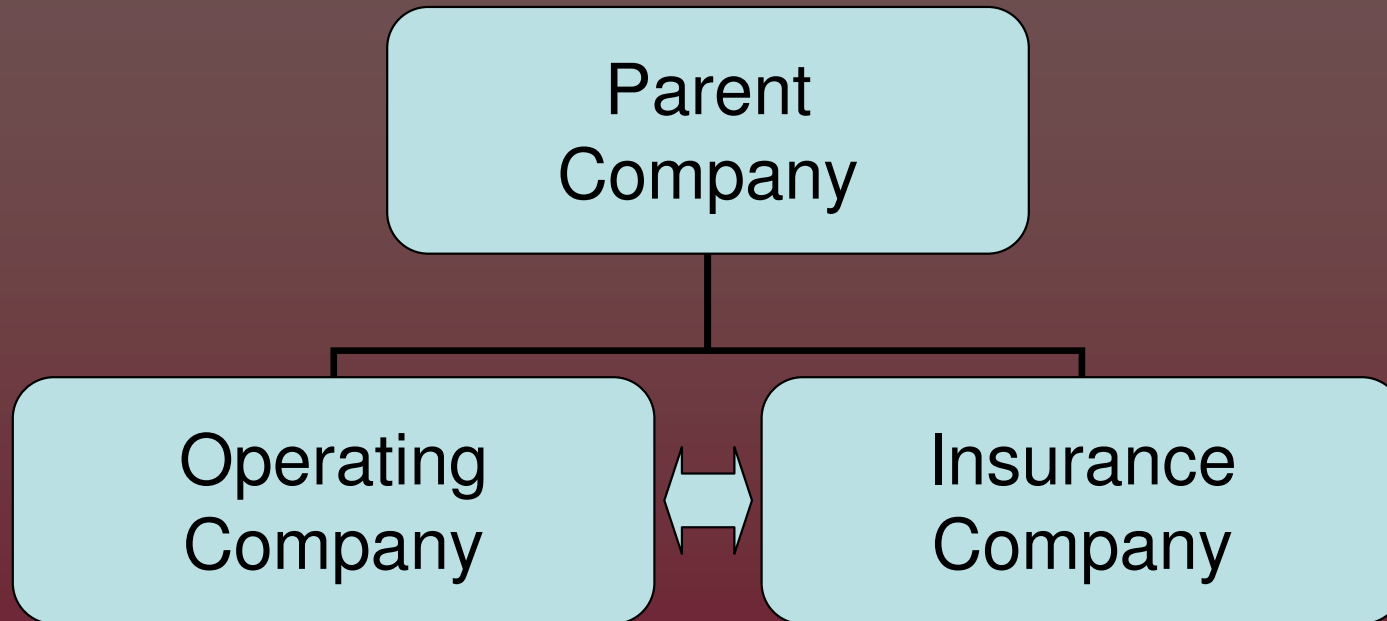
Definitions

- Single Parent:

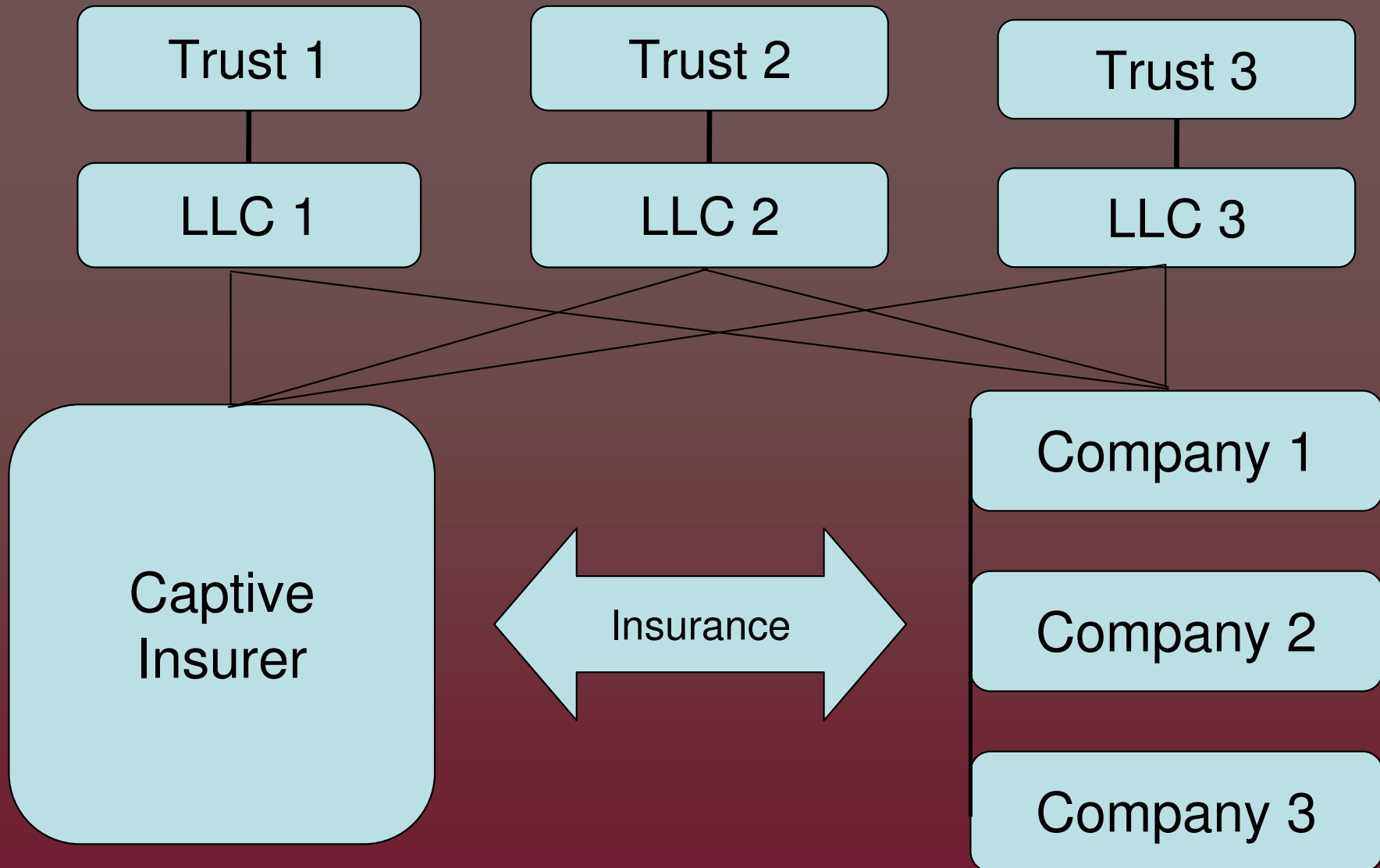


Definitions

- Brother/Sister

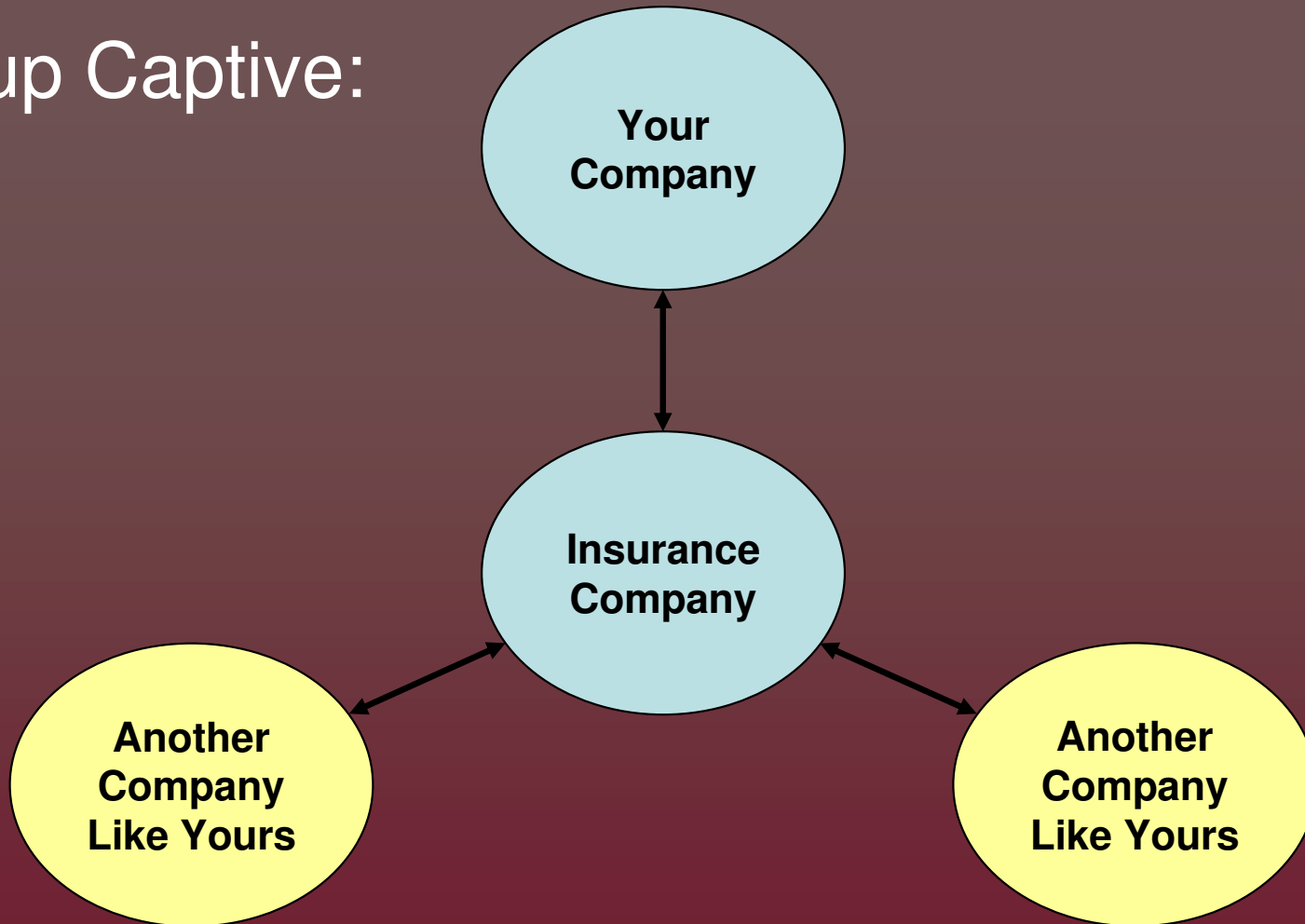


Definitions



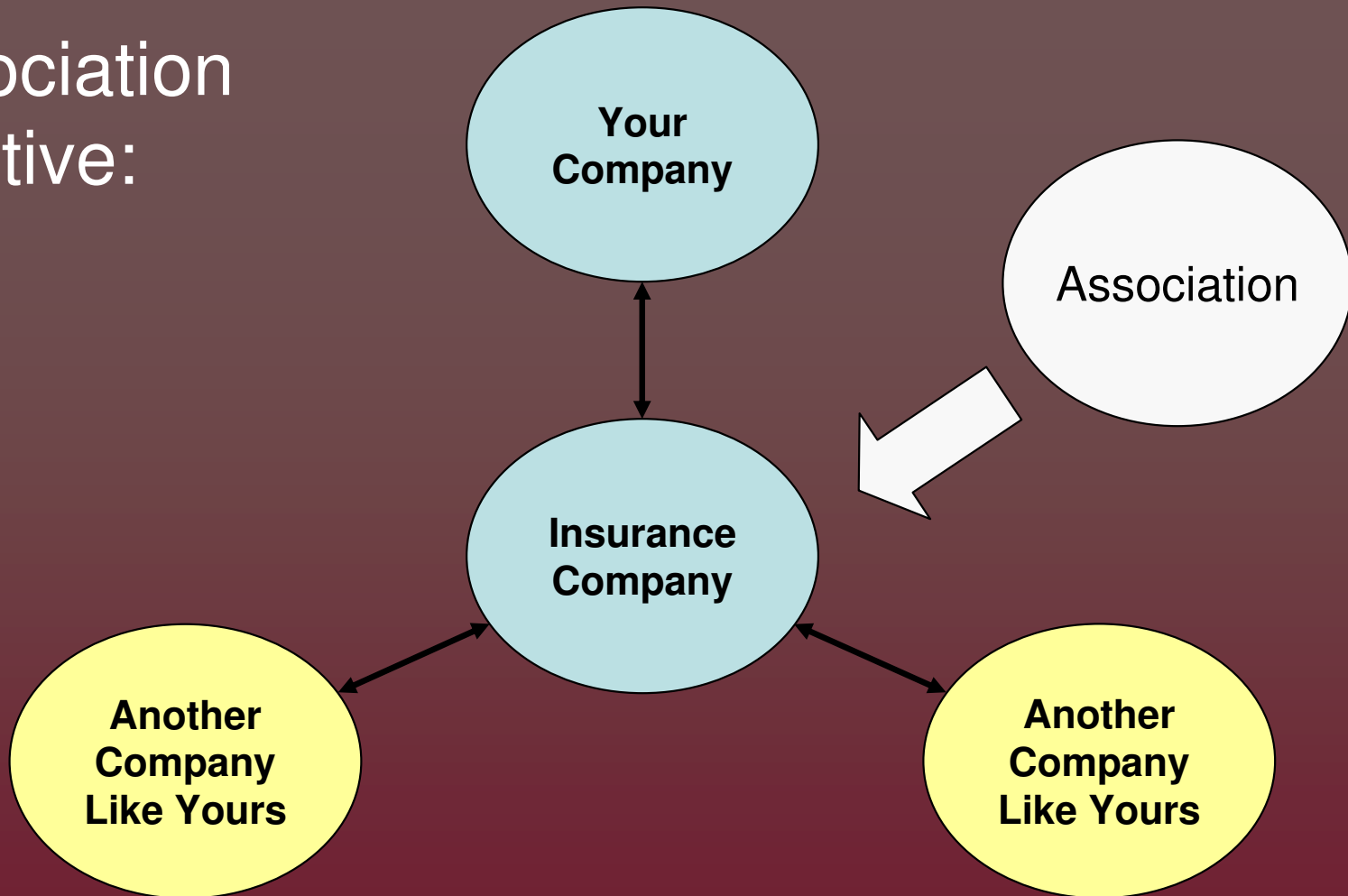
Definitions

- Group Captive:



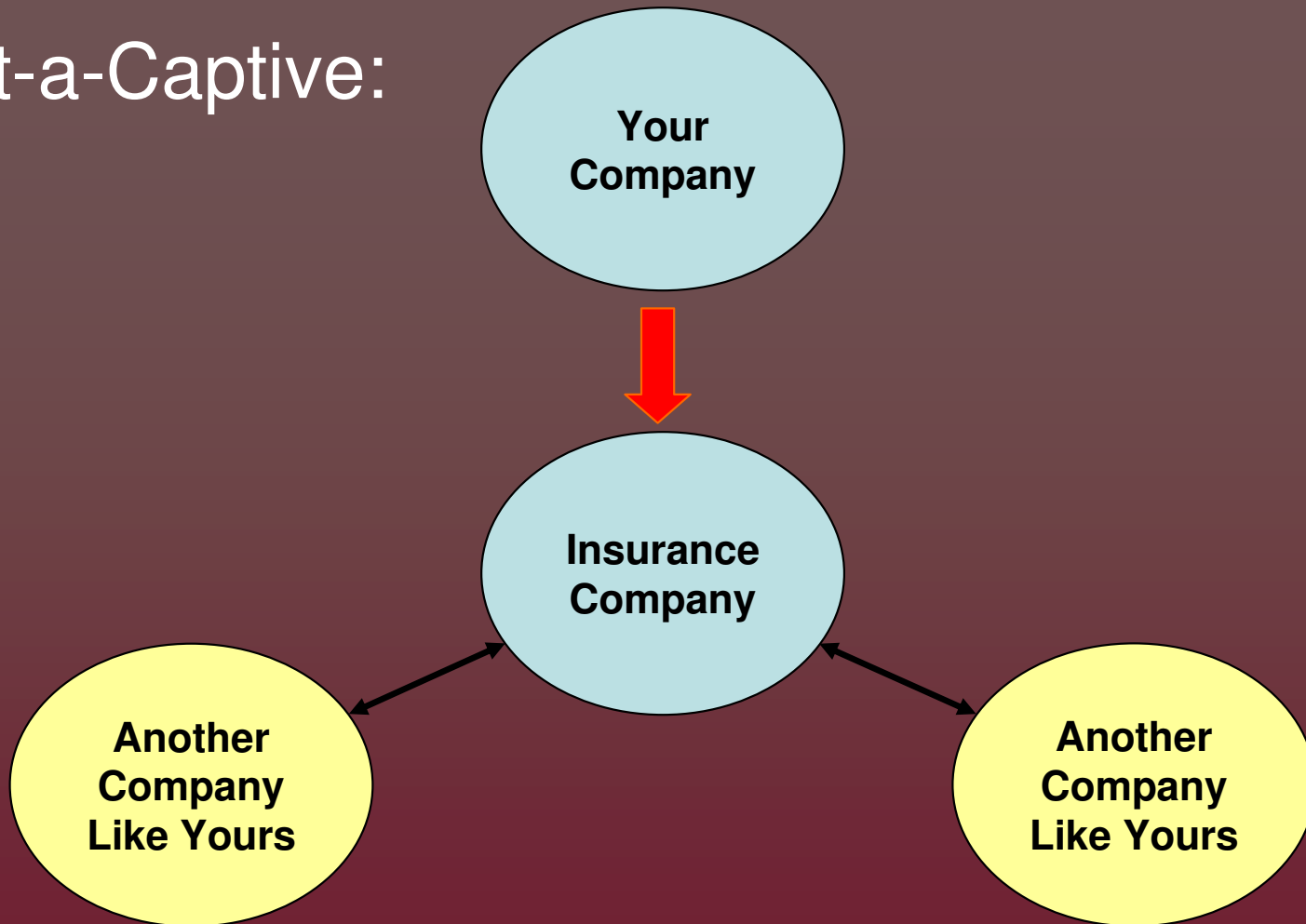
Definitions

- Association Captive:



Definitions

- Rent-a-Captive:



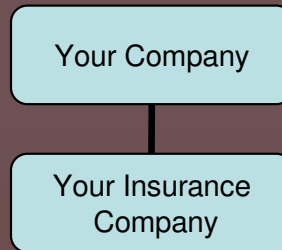
Definitions

- Protected Cell Captive:

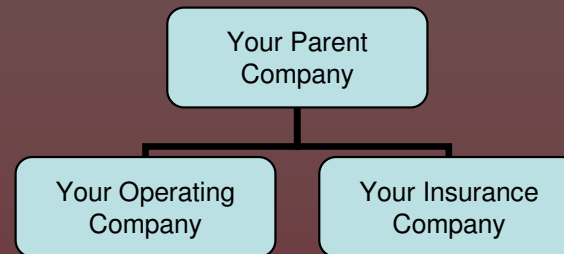


Three Basic Flavors

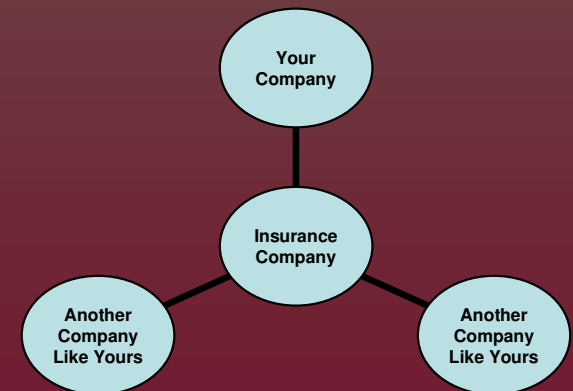
Single Parent:



Brother/Sister:



Group Captive



Why Use a Captive?

Benefits of Captive Insurance

- Select risks to insure
- Direct access to reinsurance
- Control premiums
- Coverage for uninsurable
- Control claims
- Tax benefits
- Profit from ownership

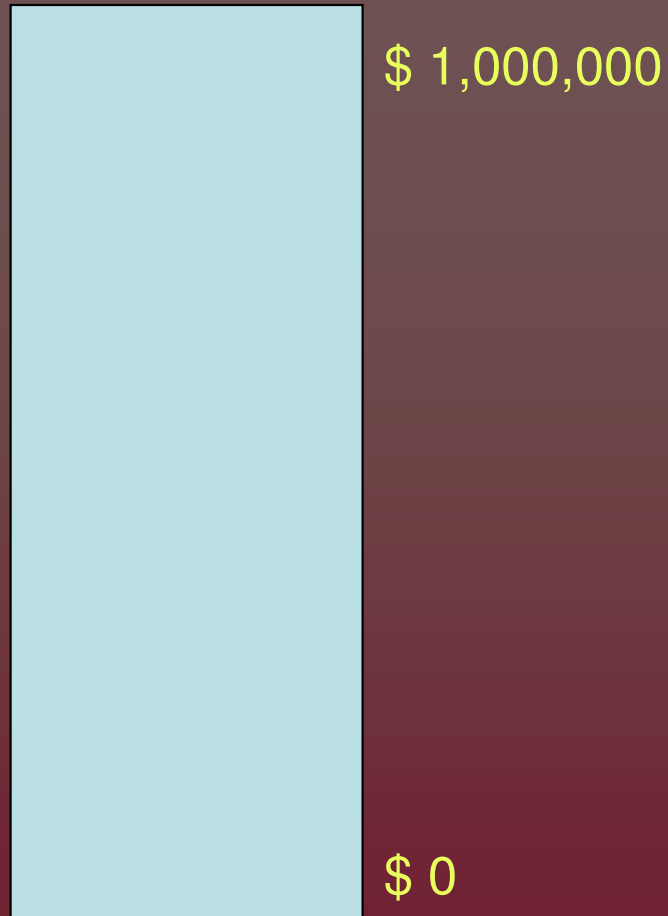
Benefits of Captive Insurance

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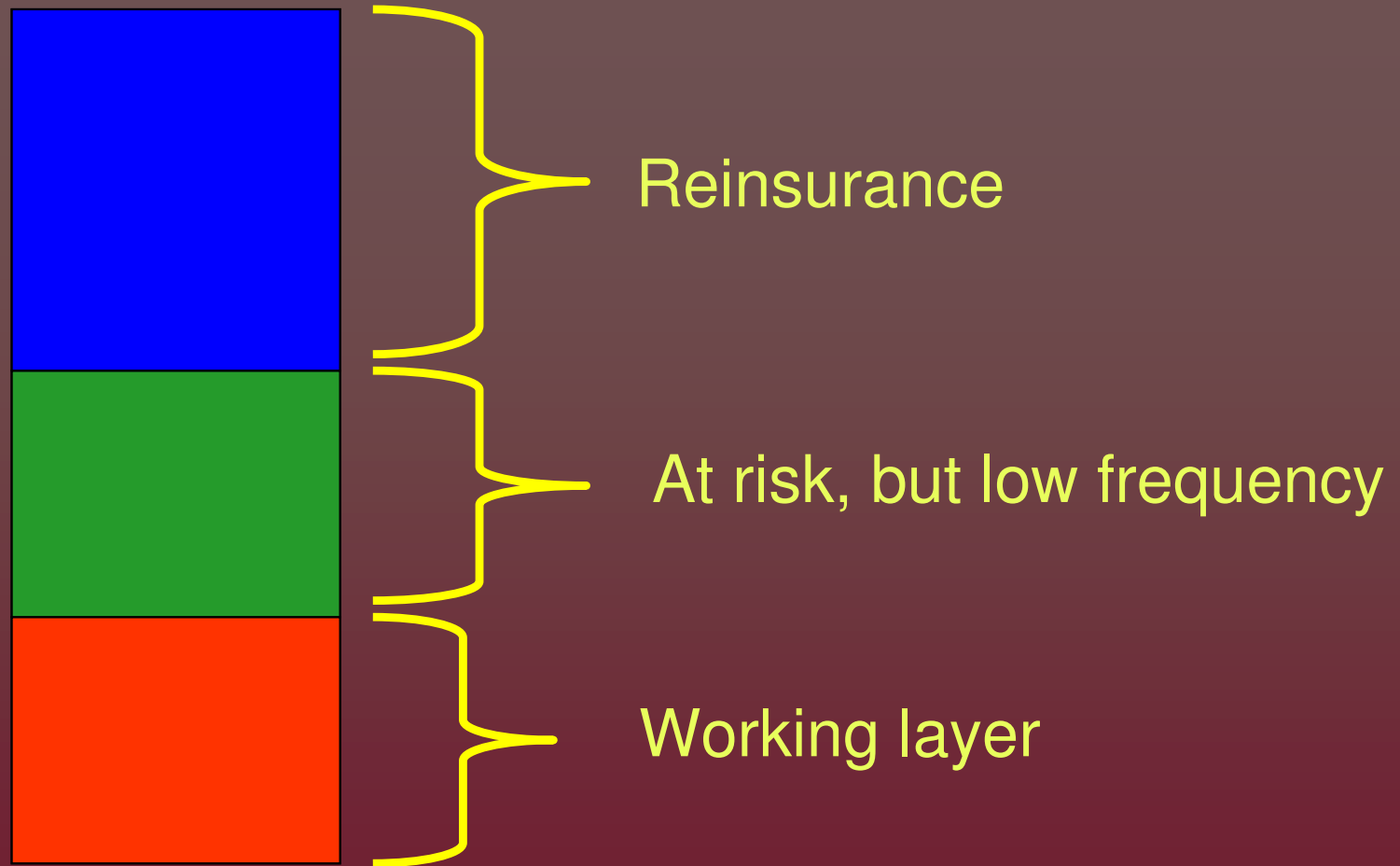


Control

Control Over Amount of Risk



Control Over Amount of Risk



Control Over Type of Risk

Bars coverage for property damage to:

j(6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

Control Over Type of Risk

Some CGL policies include:

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

Control Over Type of Risk

Your work is defined in part as:

“Your Work”:

a. Means:

*(1) Work or operations performed by you
or on your behalf; and ...*

Control Over Type of Risk

Definition in policy issued by captive:

“Your Work”:

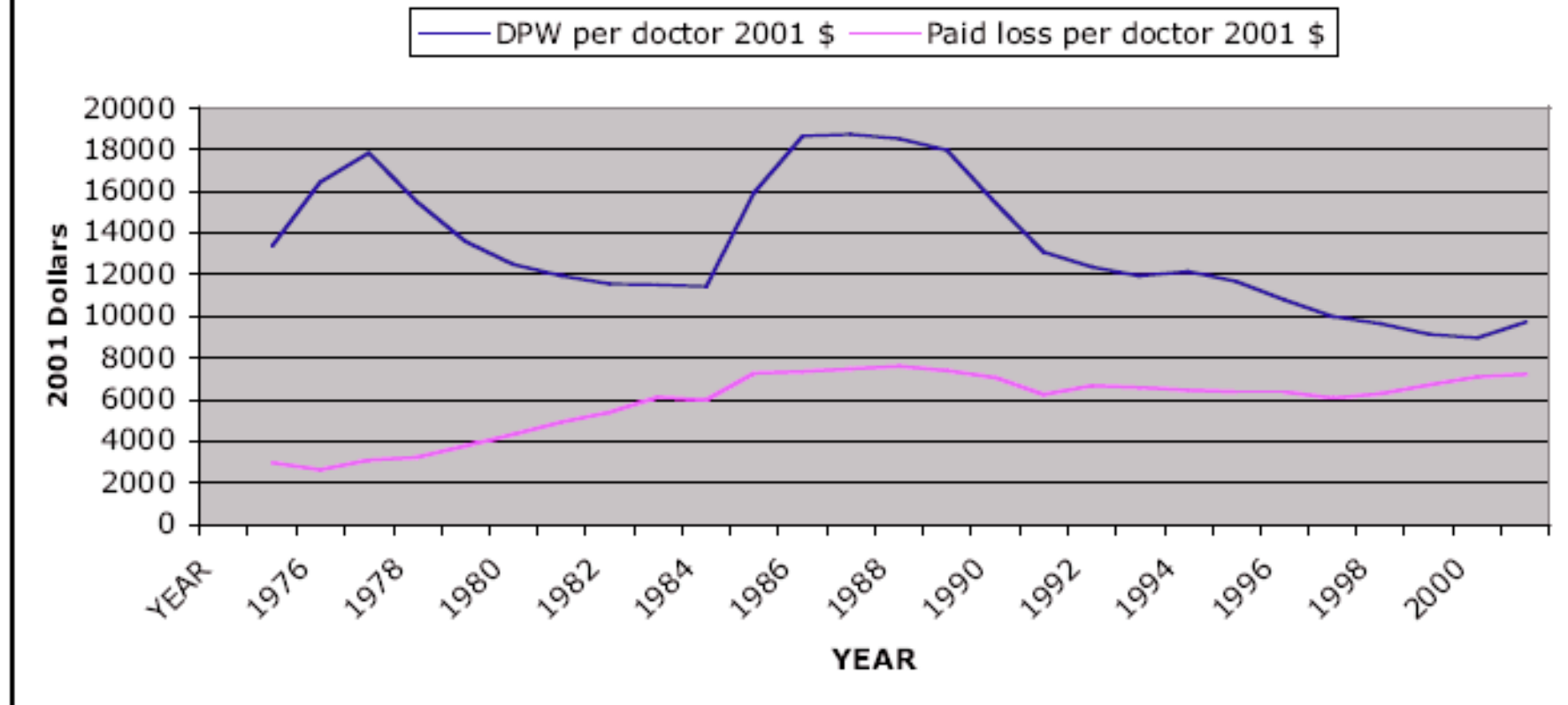
a. Means:

*(1) Work or operations performed by you
or those under your direct control ...*

Control Over Premiums

A Case Study in the
Professional Liability
Insurance Cycle

PER DOCTOR PREMIUM AND LOSSES

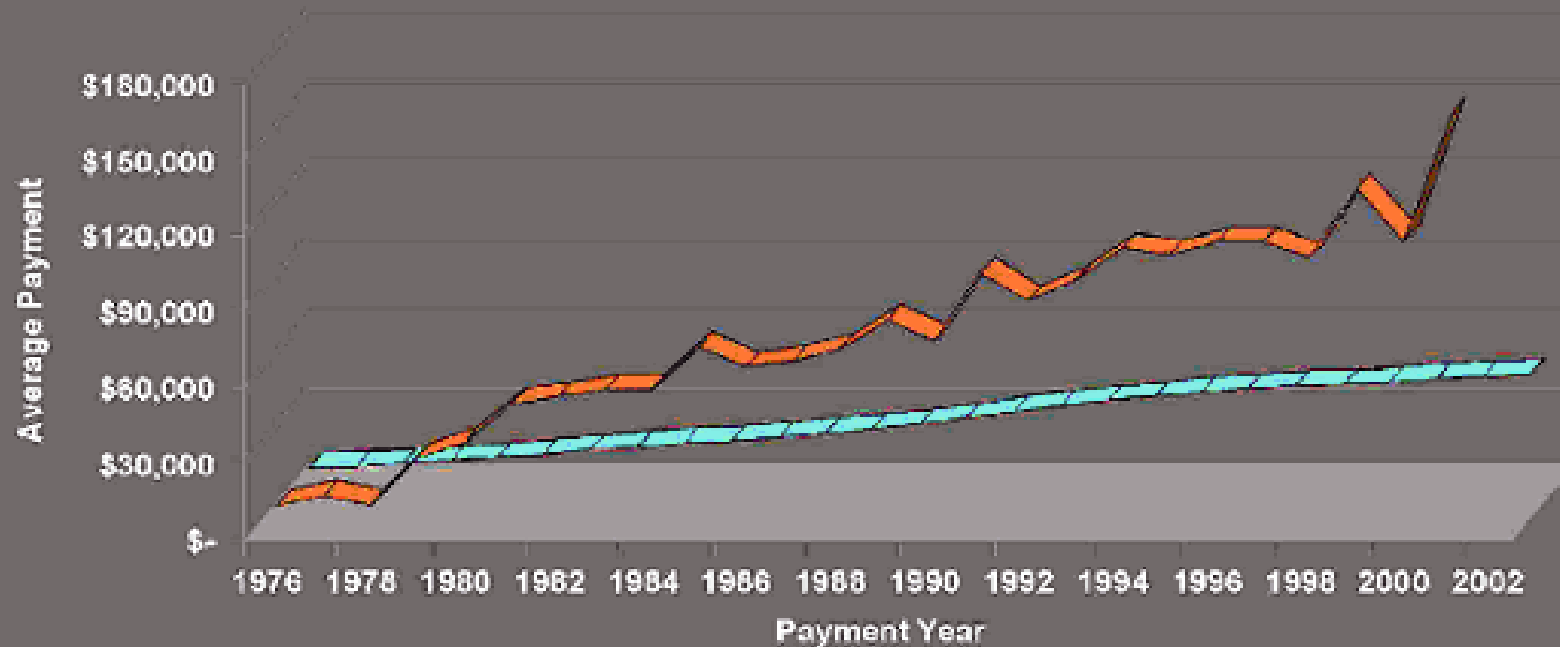


Sources:

A.M. Best and Co. special data compilation for AIR, reporting data for as many years as separately available; U.S. Bureau of the Census, 1975 (2001 Estimated)²; Inflation Index: Bureau of Labor Statistics, 1975 (1985 estimated).

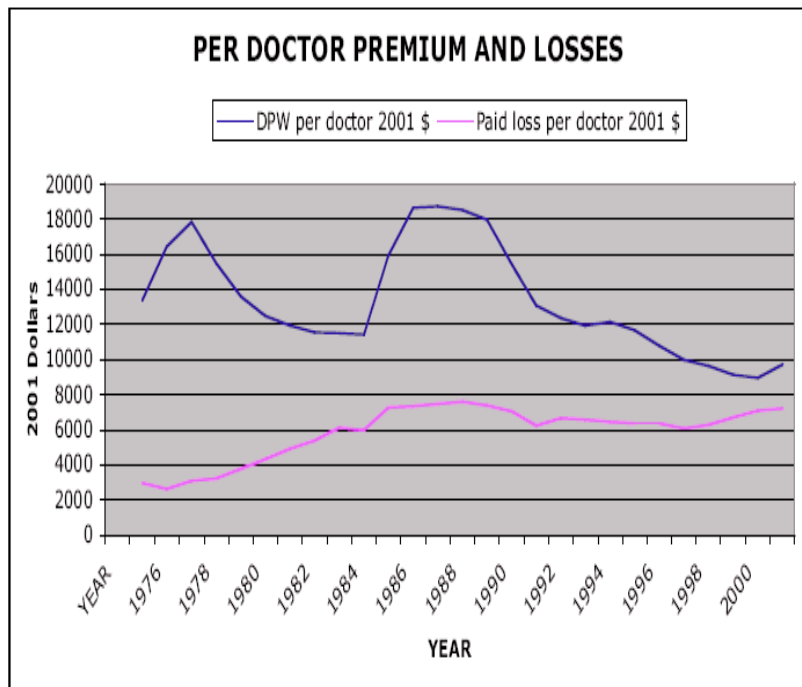
Average Medical Liability Claim in CA vs. Average Claim Adjusted for Inflation 1976-2001

THE DOCTORS COMPANY



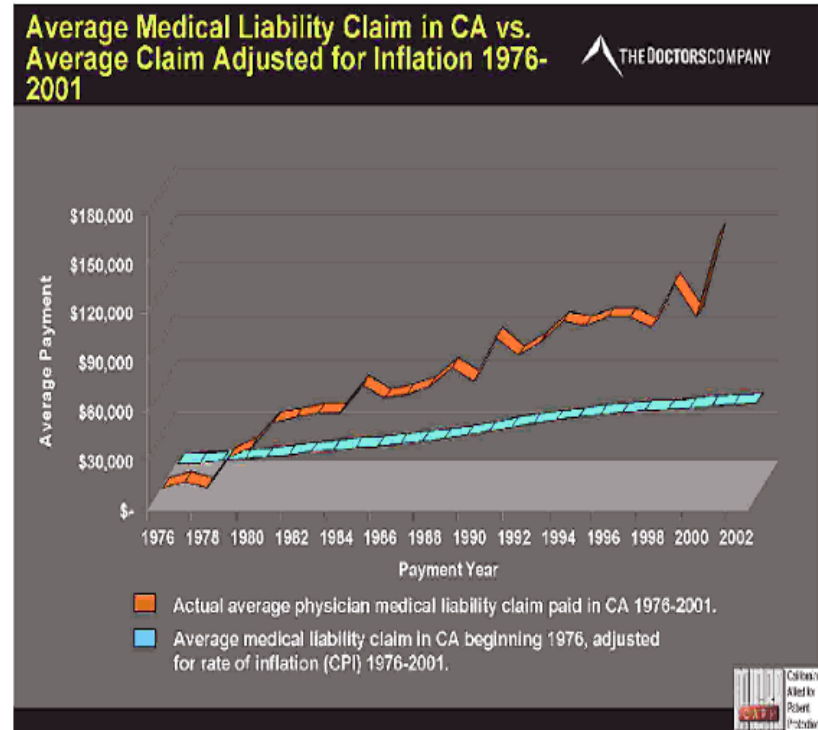
- Actual average physician medical liability claim paid in CA 1976-2001.
- Average medical liability claim in CA beginning 1976, adjusted for rate of inflation (CPI) 1976-2001.





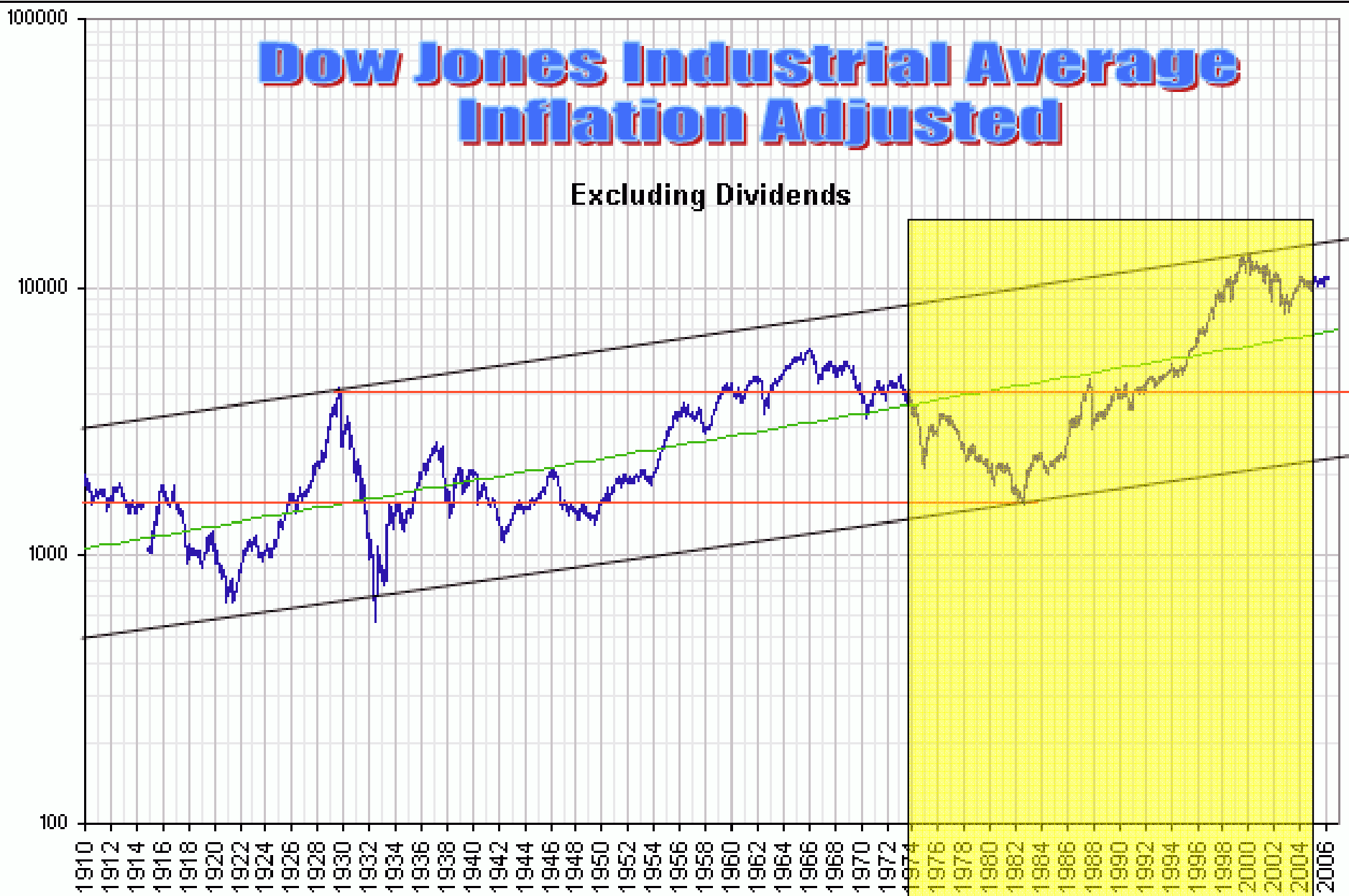
Sources:

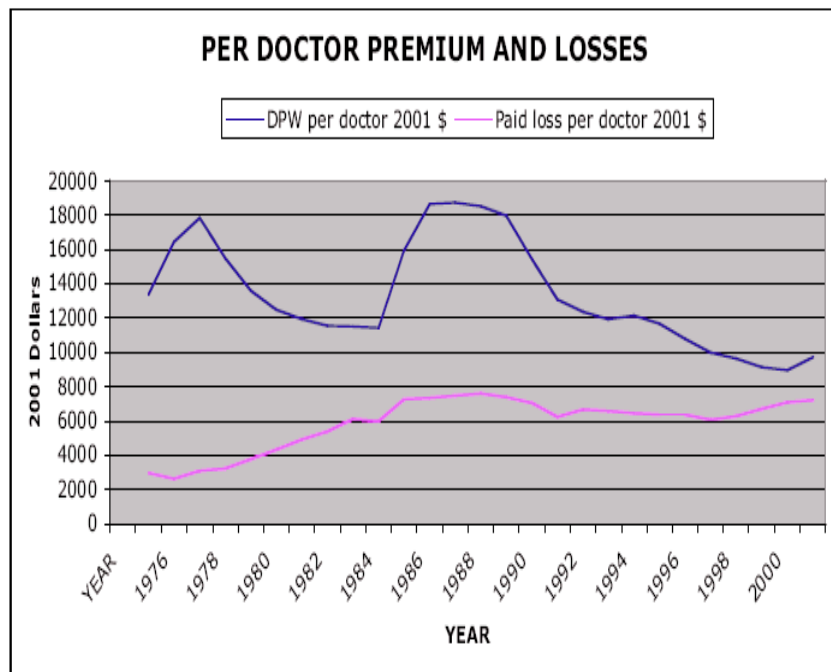
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Dow Jones Industrial Average Inflation Adjusted

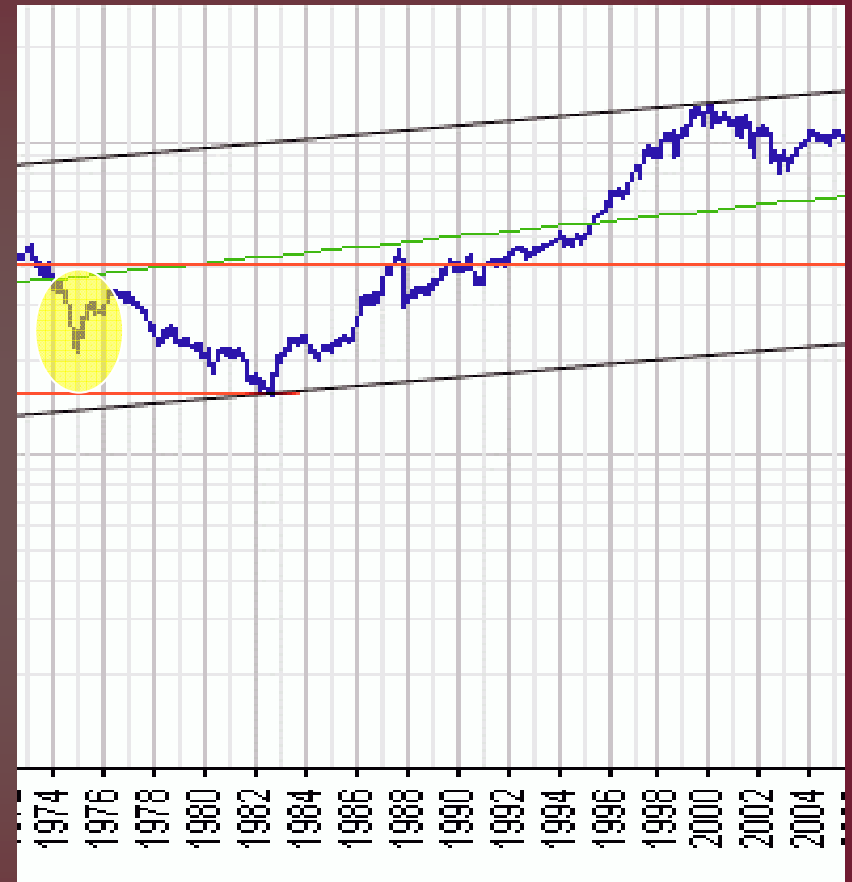
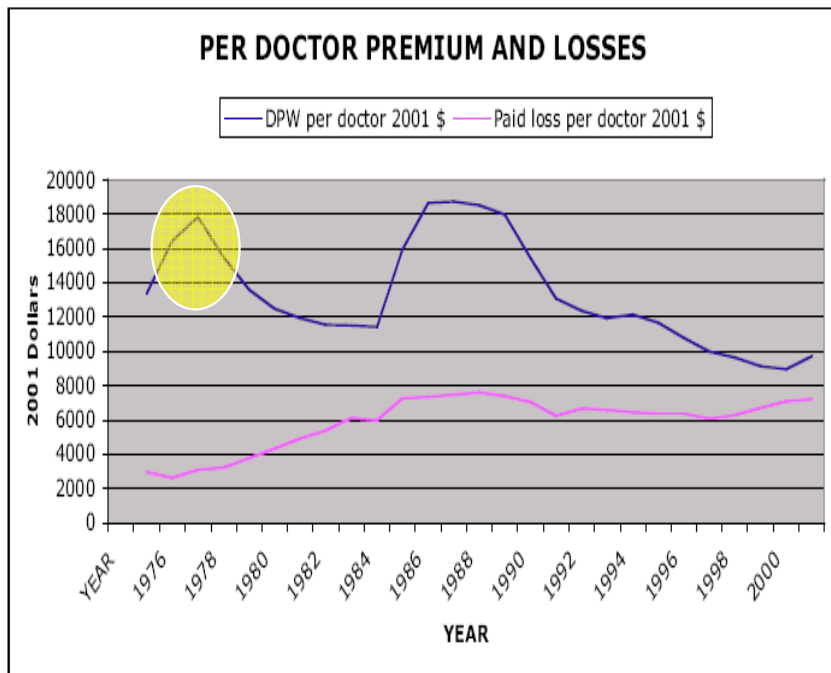
Excluding Dividends





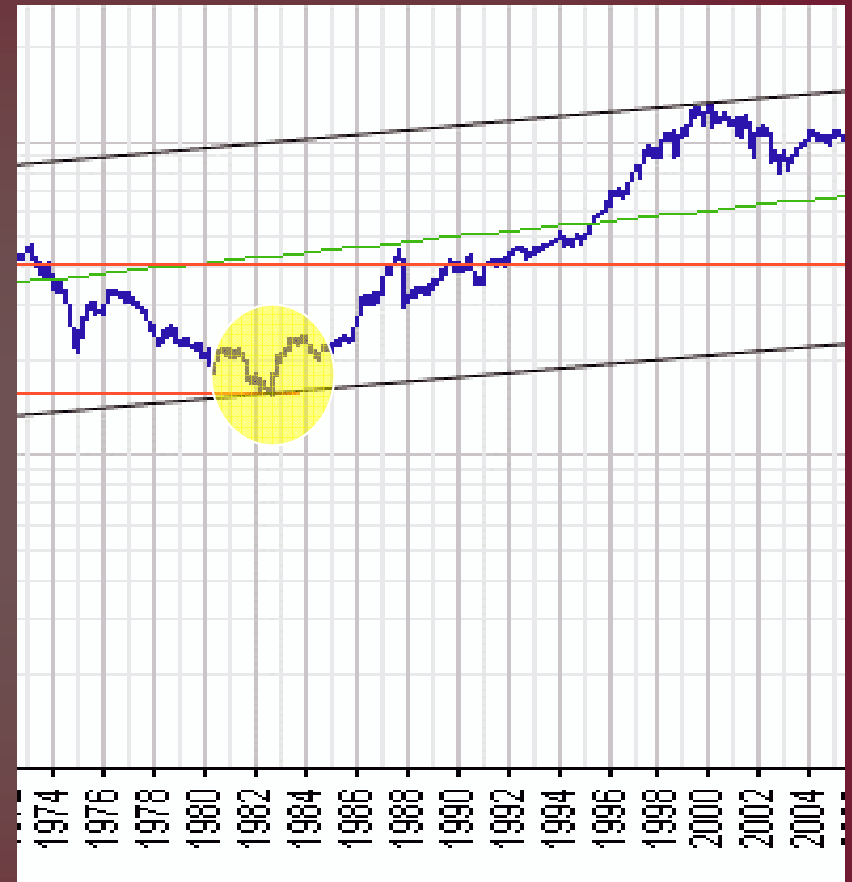
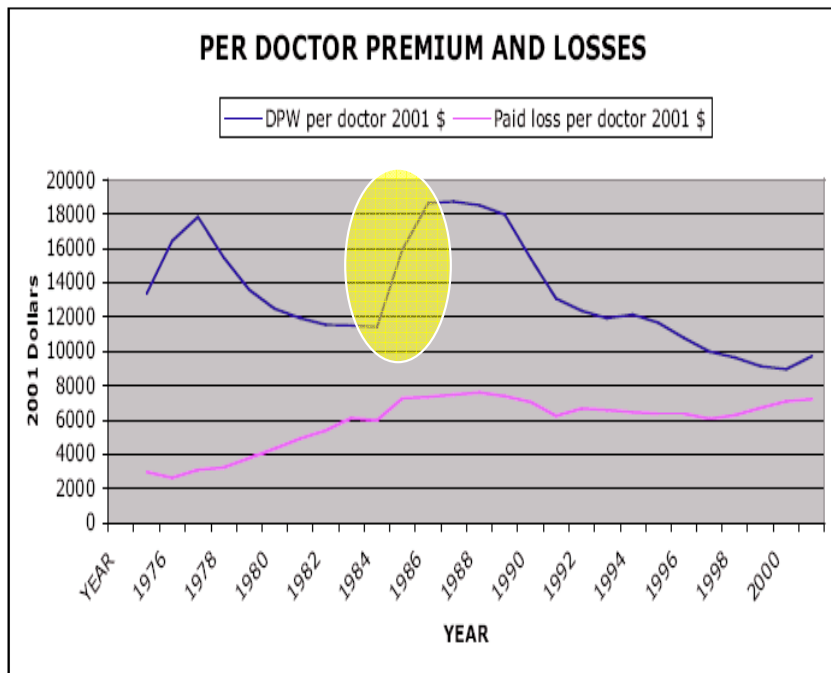
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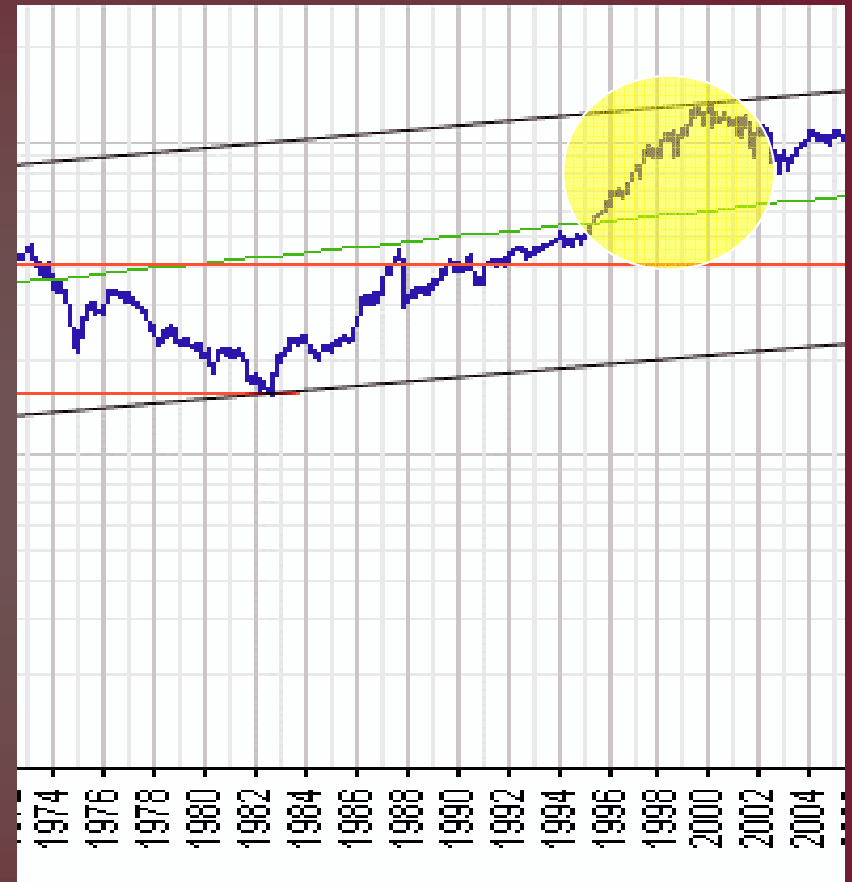
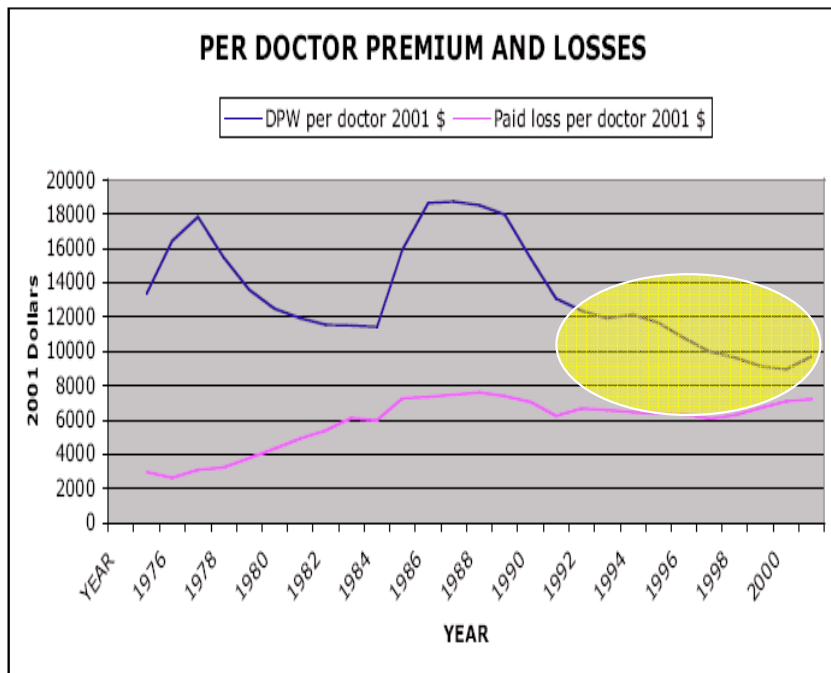
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The Insurance Cycle

High
Investment
Income

The diagram illustrates the insurance cycle with two overlapping waves. The top wave, representing high investment income, starts at a high point on the left, dips, rises to a higher peak in the middle, dips again, and then rises to a final peak on the right. The bottom wave, representing selling insurance at a loss, starts at a low point on the left, rises to a peak in the middle, dips, and then rises to a final peak on the right. The two waves are out of phase, with the peaks of one wave occurring at the troughs of the other.

Sell Insurance
at Loss

The Insurance Cycle



Premium Increases to Recover
Both Past and Current Losses

Investment
Income Drops

Benefits of Captive Insurance

- Select risks to insure
- Direct access to reinsurance
- Stable premiums
- Coverage for uninsurable
- Control claims
- Tax benefits
- Profit from ownership



Control

What does it take to
create a captive?

Domicile is the Most Important Issue

Domicile = Regulation

- Non-U.S. domiciles
- U.S. domiciles
 - Last solely state regulated industry
 - Regulated separately by each state
 - Exception: Federal Risk Retention Act

Domicile = Regulation

- Key issues
 - Capital requirements
 - “Friendly” Regulators
 - Fees & Taxes
 - Ownership structure
 - Asset protection
 - Solicitation

Captive Creation

- Domicile
- Coverage Structure/Policy Creation
- Feasibility Study
- Offering Circular
- Service Providers
 - Local Manager
 - Actuary
 - Accountant
 - Lawyer
 - Reinsurance Intermediary
 - Claims management

Putting It All Together

Using A Captive

Multi-Owner Project

- 70 Units
- Construction Costs - \$27,000,000
- Gross Sales – 40, 000,000

Multi-Owner Project

- 70 Units
- Construction Costs - \$27,000,000
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- Insurance
 - CGL
 - Excess
 - Pollution

CGL

- \$1M/\$2M
- \$50,000 SIR
- Premium: \$600,000

Excess

- Two policies
 - \$10M x \$2M
 - \$20M x \$10M
- Total Premium - \$375,000

Pollution

- \$1M
- \$50,000 SIR
- \$150,000 Premium

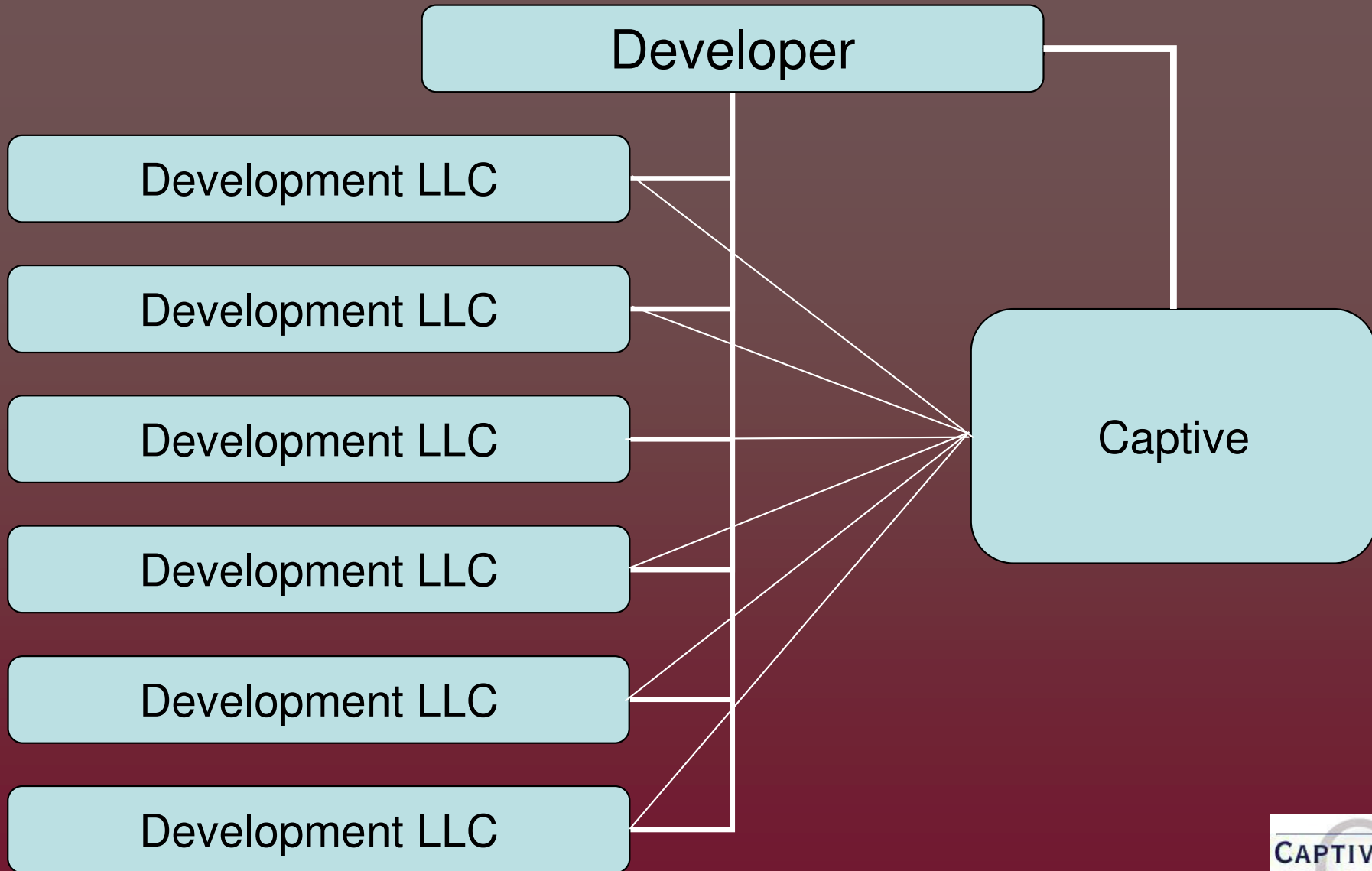
Exclusions

- Employers Liability
- Pollution
- Fungus/Mold
- Employment Practices Liability
- Professional Liability
- Continuing or Progressive Damage or Injury
- Work or Impaired Property
- Earthquake
- Flood

Captive Policies

- Amount of Risk
 - Insurer SIR
 - Take an excess layer
- Type of Risk
 - Any express exclusion
 - Other uninsured risks
 - Business Interruption
 - Terrorism
- Control Premium
 - Increase SIR
 - Lower Limits

The Developer's Long Tail



Insuring the Clean-up

Owner

Offshore
Captive

Disaster Recovery
Company

Property insurance on 5 offices
Worker's Compensation Excess
Employee Fidelity & Theft
EPLI
D&O

Warranty
Job Completion Bond
Business Interruption
Equipment Loss
Pollution/Mold