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HOW TO IDENTIFY *AND* PREVENT FORMING A PROBLEMATIC CAPTIVE

By William York, VP of Marketing

Legitimate captive transactions are powerful business tools that successful business people often utilize. A captive is consistent with what the large corporations in America have been doing for over 40 years (such as IBM, Apple, Costco, Dunkin Donuts, to name a few.)

Captives are insurance companies, and with that said, they need to operate as insurance companies. Although a captive can be lucrative, it needs to be formed based on certain criteria.

Evidence of a Questionable Captive Arrangement

1. Premium pricing that is not actuarially determined.
2. Prearranged written or verbal understandings that, very few claims, if any (even legitimate ones) will be filed.
3. Prearranged understanding that will insulate one or more insureds from bearing a meaningful portion of losses associated with claims filed by other insureds.
4. Actuaries who ignore sound modeling and knowingly overprice policies or don't provide sufficient documentation as to how premiums were derived.
5. Premium amounts that are fraudulently altered by a captive manager, attorney, captive owner or any party after an actuary completes legitimate pricing calculations.
6. A captive that is formed for tax or estate planning reasons only, with little or no attention paid to risk management.
7. A captive owner that treats the reserves in the captive as a personal checking account.
8. A captive owner that uses the reserves in the captive to invest in ways that benefit the owner personally while jeopardizing the claims paying ability of the insurance company.
9. Using a captive as a "pass-through" vehicle and withdrawing material amounts of money very soon after the captive is formed.
10. Premium amounts that are simply made-up or determined without reference to the particular unique risk profile of the insured.
11. Premium amounts that are not adjusted over time to account for the changing circumstances of the insured or the claims experience of the industry as a whole.

(When it comes to premiums, one can't simply "set it and forget it").

12. Using Captive Managers that are not credentialed/competent/licensed.
13. Captives that insure only one, or very few, entities (i.e., small captives with no risk pool or reinsurance arrangement).
14. Captive owners that do not engage competent professionals (captive managers, actuaries, claims administrations, lawyers, etc.) in order to ensure that the captive is managed properly and that the insurance policies are priced properly.

How PIM (Private Insurance Management – Captive Manager) evaluates the formation of a Captive.

1. The primary reason for forming a captive is **ALWAYS** risk management.
2. We believe a financially strong captive is a more powerful risk management tool.
3. We believe a captive should be structured to optimize both risk management and asset accumulation. The greater the asset accumulation, the more effective the captive is to serve its insured parties and owners.
4. This is accomplished by developing an expert team of professionals in the captive insurance area. Obviously, many questions need to be answered before undertaking a major commitment of forming and operating a captive insurance.
5. There are proper resources available. PIM has developed a system to make this process less cumbersome and less threatening than it appears. Finding the expertise can provide huge benefits for many business owners as doing it correctly is certainly worth the effort.
6. PIM has guided and assisted many mid-size businesses in order for them to understand and employ these techniques successfully.

We create a solid and functional captive to protect your business by offering the following:

- Comprehensive Business Risk Assessment
- Strategic Risk Management Plan
- Superior Structuring with the Captive
- Superior Asset Management Strategies

Please call Paul Hyl, Esq. at 516-880-5349 to discuss any questions you may have about risk management and captive insurance companies.

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