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Client Alert: Ohio's New Captive Insurance Company Law Becomes Effective September 17th

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Now that Ohio's Captive Insurance Legislation is effective, companies are likely thinking: "What are my next steps?" Each Captive is unique and its creation and operation will depend on a number of factors, including the business purpose behind forming the Captive. A company considering the use of a Captive will need to weigh the positives and negatives associated with forming and operating a Captive. If a company decides to proceed with a Captive, we recommend retaining a risk management expert to assist you with the preparation of a feasibility study that will further evaluate your potential benefits and use of a Captive. We would be happy to provide a list of recommendations.

Considerations

Although the following lists are not exhaustive, a company considering forming a Captive should consider at least the following:

Positives

Negatives

- May provide improved risk management
- May likely result in a reduction of insurance costs
- May create a tax benefit
- Will allow customization of insurance coverage
- Will allow control of the insurance claims process
- May provide investment income
- May provide underwriting income
- May permit you to insure an otherwise uninsurable risk
- Will insulate you against commercial insurance market cycles
- Will provide you access to the wholesale reinsurance market

- Requires a significant outlay of capital and time in order to be formed and licensed
- Requires that a significant amount of capital be maintained
- Is subject to a regulatory scheme that is significantly different than the general corporate law
- Is subject to regulatory sanctions and fines if it is not operated appropriately
- May create unexpected tax liabilities if it is not established and operated in accordance with Internal Revenue Service (IRS) requirements
- Will have ongoing expenses related to its regulation that does not benefit the profitability of the company

Feasibility Study

The feasibility study, while expensive (\$25,000 - \$100,000 range), will provide the company with information that permits its management to make an informed decision as to whether a Captive will be beneficial to the company. Generally a feasibility study will provide the following information to a company's management and also serve as a business plan for the creation and operation of the Captive:

- Identify the risk management objectives and areas of concern;
- Provide an assessment of current commercial insurance coverage and identify any gaps that may exist in such coverage;
- Provide an analysis of the company's historical loss data;
- Identify the types of coverage the Captive will need authority to write in order to be successful;
- Provide an estimate of the costs associated with the new Captive coverage;
- Provide an estimate on the total annual operating costs associated with the Captive;
- Identify the minimum capital and surplus that will be needed to form and operate the Captive;
- Provide a cost-benefit analysis of operating a Captive;
- Provide a financial analysis of operating the Captive; and
- Analyze tax implications associated with the Captive.

The feasibility study will also include a qualitative and quantitative analysis that outlines the type of coverage written and the risks retained, and will likely include pro forma financial statements that highlight the financial commitment that will be necessary based upon projected losses and investment returns. We recommend that the feasibility study be performed prior to committing to the creation of a Captive. This will likely prevent you from expending the resources to create a Captive that does not turn out to be beneficial. In addition, the feasibility study can be provided to the IRS during an audit to demonstrate the business rationale for creating the Captive and demonstrate the risk transfer associated with the Captive.

The feasibility study can be performed by several professionals including, actuarial firms, insurance brokers, captive consultants or captive managers.

Creating the Captive

After you have received and reviewed the feasibility study and decided to move forward with the creation of a Captive, you will want to secure the assistance of a team of professionals that should include an attorney, accountant, actuary and captive manager. These professionals will assist the company with the creation and eventual operation of the Captive.

Before creating the Captive, your team of professionals should meet with the appropriate regulatory agency responsible for licensing your Captive. After holding informal discussions with the regulator (which will assist your team in avoiding any surprises related to the licensing process), your team of professionals will form the appropriate Captive entity, obtain a tax identification number, organize the Captive, make any necessary tax election, assist with the opening of bank accounts, develop insurance premium rates, create procedure manuals, adopt the business plan and necessary budgets, and perform any other activities needed to properly commence and document the operation of the Captive. Your team will also need to prepare the appropriate paperwork related to the licensing process, which will generally require at least the following: the Captive's financial statements, biographical affidavits of the officers and directors of the Captive, reinsurance agreements to be used by the Captive, the Captive insurance policies to be issued, the Captive's investment policies, and the entity's formation documents.

After the regulator has reviewed the Captive application and it appears that the Captive will be issued its license, the parent company creating the Captive will need to fund the Captive with the minimum required capital and surplus. If the entity being formed is an Ohio Captive, the amount of minimum capital and surplus required is \$250,000. The assets permitted to comprise the minimum capital and surplus can include cash, approved marketable securities, and certain letters of credit.

You should hire experienced reputable professionals to guide you through these processes and we recommend against selecting service providers solely on price. At Vorys, we can help guide you through this process. If you have any questions regarding Ohio's Captive Legislation or wish to discuss the possibility of forming your own Captive, or are approached by others regarding the creation of a Captive and would like another opinion, please contact Tom Szykowny (teszykowny@vorys.com or 614.464.5671), Anthony Spina (aspina@vorys.com or 614.464.4958) or Gregg Zelasko (gjzelasko@vorys.com or 614.464.6416).