

The logo for Captive Strategies features a large, light gray, stylized 'C' shape that curves around the text. The text 'Captive Strategies' is written in a purple, serif font, with 'Captive' on the top line and 'Strategies' on the bottom line.

Captive Strategies

ICS ALTERNATIVE RISK FINANCING NEWSLETTER January 2008

IN THE SPOTLIGHT: Has the IRS Lost Its Mind?

That was the headline in a recent article published by IRMI. It reflected the amazement expressed by many following the release of a proposed new regulation by the Internal Revenue Service. While group captive owners would not be impacted if the regulation is passed, it would prevent a single parent captive that is part of the same consolidated tax return as the premium payer from treating the transaction as if it is insurance. Insureds would therefore lose the benefit of deducting reserves and would deduct only paid losses and expenses. The only exception, under the proposed regulation, would be if the single parent captive had at least 95% of its premium from unrelated (non-shareholder) sources.

The IRS appears to remain convinced that single parent captives are not “real” insurance companies, and therefore should not be treated as such for tax purposes. The big surprise is that by issuing this regulation, the IRS is attempting to disregard a significant number of court cases as well as their own previously issued Revenue Rulings that supported the deduction of premiums paid to single parent captives, regardless of whether the single parent captive’s financial results are consolidated with its shareholder insureds. The trade associations that represent captives (notably Captive Insurance Company Association and the Vermont Captive Insurance Association) have joined forces to make sure this regulation goes no where. ICS supports their efforts, and remains optimistic that the regulation will not be promulgated.

Meanwhile, can or should captive insureds be doing anything to minimize the potentially negative impact of the IRS’ ongoing “war on captives”. ICS works with captive owners to structure captive programs that evidence risk transfer and risk sharing, and constantly reiterates the importance of documenting that the captives operate in accordance with accepted insurance company practices. Could we do more?

Especially for single parent captives, this may be an opportunity to re-evaluate the ownership structure of the captive, or the identity of the captive participant, if a rental captive is used. Is there a way to more firmly establish the arms length relationship between the captive and its insureds, by differentiating the ownership of the captive from the ownership of the insured entities?

The IRS can challenge actions taken solely for the purposes of gaining a tax benefit. However, a corporate reorganization can have a non-tax business purpose, being undertaken to help shareholders better manage their risk. The consequence of removing the single parent captive from the insured’s consolidated tax return will simply be a desirable consequence. Exploring ownership and organization options makes perfect sense, regardless of whether the IRS finds its mind again.

HOT TOPIC: What is safety culture and why is it important?

As John Anderson, ICS’s risk management team leader explains, an organization with a “safety culture” is one that realizes safety should be a core value not just a priority. What does this mean?

We certainly expect that senior management or the owners of a company that participate in a captive program will make risk management a top priority. But risk management programs may not reach their potential, or could even fail, if the safety culture of the organization has not been changed.

Cultures consist of shared beliefs, practices and attitudes that exist within organizations or between groups of people. Culture is the atmosphere created by those beliefs and attitudes that shape our behavior. Companies that successfully change their safety culture acknowledge that risk management requires more than putting safety programs in place to help avoid or reduce the number of accidents, and informing all employees that they are required to adhere to these programs. The culture will only change when everyone, from top to bottom of the organization, understands and believes in the value of risk management, and believes it to be their personal responsibility.

In organizations with a strong safety culture, everyone feels responsible for safety and pursues it on a daily basis. Employees go beyond the norm to identify unsafe conditions and behaviors, and intervene to correct them. In a strong safety culture any worker feels comfortable walking up to another employee and reminding them to wear their personal

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protective equipment. This type of behavior is not viewed as forward but would be valued and rewarded by the organization.

A company with a strong safety culture typically experiences few at risk behaviors; consequently, they also experience low accident rates, low turn over, low absenteeism, and higher productivity. However, creating a safety culture takes time. Usually it is a multi-year process. Employer and employee commitment are trademarks of a true safety culture where safety is a part of daily operations. Over time, the beliefs of an organization shift from eliminating hazards to eliminating unsafe behaviors and building systems that proactively improve safety and health conditions. Employee safety takes precedence over short term production pressures. Production does not suffer but is enhanced due to the level of excellence developed in the organization.

Participation in a captive can be a valuable tool for companies seeking to change their safety culture. This is because it provides an opportunity for the company's owners and senior management to benefit financially from the reduction in losses. The benefit can be shared in a very practical way. One construction company that has achieved a very visible change in their safety culture announces Christmas bonuses to all employees, if safety targets for the year are achieved. That makes for a very merry Christmas, to one and all.

ICS NEWS

The Captive Professional's Development Program

Early in 2007, Teri Sporer, Kate Westover and Dana Marino led an initiative to develop a comprehensive educational platform for all ICS employees and stakeholders. The goal was simple: The development of employees to have the knowledge they need to excel at their jobs. The first part of the Captive Professional's Development Program provides "foundation knowledge"; exposing the participants to how captive insurance is currently used, not just group captives. We are happy to announce that all ICS employees took and passed a captive exam to complete the first part of the ICS Captive Professional's Development Program, and have graduated to the second part, which has two tracks – financial or underwriting.

Captive Owners' Conference 2008

As most of you know, ICS annually holds a captive owners conference. This is an opportunity for networking between captive owners and professional partners, and in addition to social events, there are a number of educational sessions. The 2008 conference will be held September 25-26, 2008, in Chicago, Illinois. **Save the Date!**

New Agency Partners

Barney and Barney is a Southern California agent that has partnered with ICS to form a new captive during 2008. ICS is also developing agency relationships in Boston, New York, and Florida.

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