CAPTIVE
REVIEW

DELAWARE REPORT 2011

DISTRIBUTED WITH CAPTIVE REVIEW

REGULATION
Robust legislation secures Delaware's position as a leading captive domicile

FLEXIBILITY
The jurisdiction welcomes and supports innovative ideas

LOCATION
A prime geographic position and excellent transport links ensures success



FEATURING Bayard | Capstone Associated Services | Parkowski, Guerke & Swayze
Stevens & Lee | Stewart Law Firm | Wilmington Trust Company

Own your own insurance company

Stewart A Feldman of Capstone Associated Services talks to *Captive Review* about why business owners should consider setting up a captive and how to go about it

Owners of middle market businesses are attracted to the cost saving, risk management, and profit potential provided by owning their own insurance company.

In a recent interview, Stewart A. Feldman, chief executive of Capstone Associated Services, a Houston-based firm specialising in alternative risk planning for closely held businesses, explained: "Many middle-market businesses needlessly 'self-insure' a wide range of risks. By self-insurance, I mean 'pay directly out-of-pocket as losses are incurred'. This is an inefficient and dangerous approach to risk planning."

As an alternative to being self-insured, a business can form its own small insurance company, or 'captive'. A captive allows the business to underwrite heretofore inappropriately self-insured risks (for example business interruption coverages) into property & casualty premiums. Like any other property & casualty premiums, a captive's premiums are tax-deductible to the operating businesses.

Operating businesses are only allowed to deduct losses as they occur. In contrast, insurance companies are unique in that they are able to currently deduct future, unspecified losses. With a captive insurance arrangement, those reserves are available to fund future losses, or in the event that the loss does not occur, the profits can be distributed to the captive's owners at advantageous tax rates. Meanwhile the captive has a wide range of investment opportunities, and if properly structured, enjoy fully or partially tax exempt status.

Stewart Feldman talks to *Captive Review* about the best course of action for a business owner to put in place a more comprehensive risk management programme that protects against a wider range of risks than currently seen covered by conventional policies.

Captive Review: How would you define a captive, and what are the particular benefits of forming one?
Stewart Feldman (SF): A captive is generally thought of as a closely held insurance company that principally insures related businesses. Today, over 90% of Fortune 1000 companies and many successful mid-market companies have captives. Forming a captive may be one of the best risk management and financial planning tools available for middle-market businesses. Due in large part to the US tax structure, most captives in the world are sponsored by US businesses (*see diagram on page 14*).

CR: What factors can make captive insurance an attractive planning tool for businesses?
SF: A captive allows its owners to specifically tailor and implement customised policies that are often too expensive or practically speaking unavailable through the conventional insurance markets. A captive provides a platinum level of coverage to an operating business, while allowing the business owners to benefit from the profits of the insurance company in a tax-efficient manner.

CR: In terms of size, which businesses would particularly benefit from forming a captive?
SF: Generally, a business owner or group of owners would form a captive for a substantial operating business (one that has meaningful uninsured or underinsured risks), with pre-tax profits (before partners' salary, bonus and other forms of compensation) of $1m or more.

CR: What are the benefits of forming a captive to the business owner(s)?
SF: The captive insurance company's potential risk management and asset protection benefits, together with the federal tax incentives, often combine to make it a very attractive option for successful business owners. The bottom line is that a captive gives owners ultimate control over their insurance needs, and in the event that premium revenue exceeds claims, owners benefit from the profits of their own insurance company. The resulting underwriting profits are tax free.

Stewart A. Feldman is CEO of Capstone Associated Services, a Houston-based firm specialising in alternative risk planning for closely-held businesses. As a 30+ year tax attorney, Mr. Feldman is one of the foremost experts on captives in the United States. Since 1998, Capstone Associated Services, together with their affiliated law firm, The Feldman Law Firm LLP, have formed 100+ captive insurance companies for closely held businesses,

CR: In the US, what measures are in place to encourage the formation of captives?
SF: Captives are tax advantaged, for-profit insurers. The US government encourages the formation of small insurers to help protect closely-held businesses as a way of promoting jobs and growth. While a captive may be a great financing tool, it does not work for every business. Provisions in the Internal Revenue Code have been in place prior to 1920 providing tax exempt treatment for small insurance companies. Similar provisions now apply to insurers with annual premiums under $1.2m.

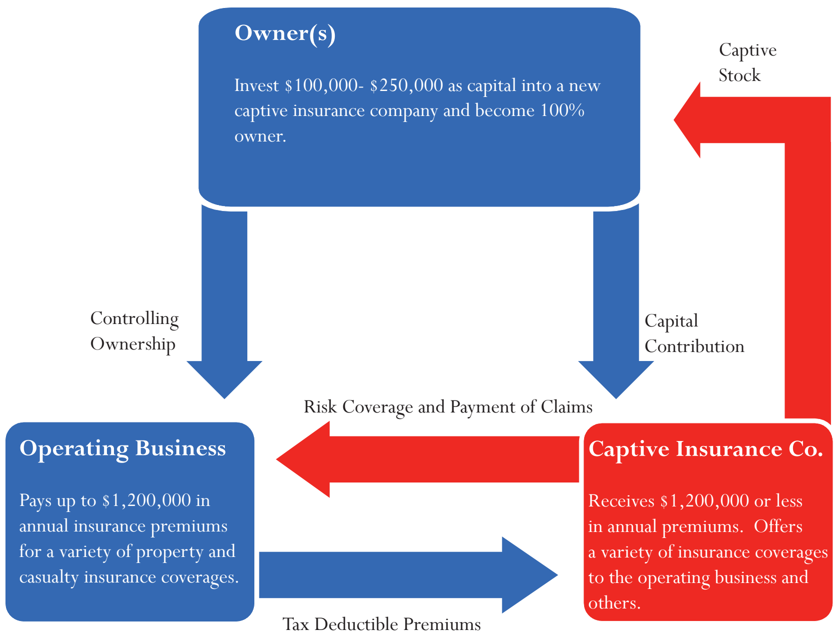
CR: Why would a business owner form a captive rather than using a traditional insurance company?
SF: Captives typically provide supplemental coverage to existing conventional policies, which upon examination are often found to be inadequate. Business owners find that owning their own insurance company helps control the rising cost of risk and provides broader insurance protection by filling in the holes and exclusions of conventional policies that all too often do not match the risks of the operating businesses.

CR: Is it necessary for the business owner to be the sole owner of a captive?
SF: Ownership of the captive often mirrors the ownership of the operating business. However, the ownership of a captive might also include key employees, children, grandchildren, family partnerships, limited liability companies or trusts.

CR: How would business owners protect their assets?
SF: Captives are one of the better asset protection tools available. Designed correctly, assets in a captive are difficult for the operating companies' creditors to reach.

CR: Is a captive easy to establish and manage?
SF: Captives must operate with dual regulatory parameters: the Internal Revenue Code and the domicile where the insurance company is established. The formation and ongoing management of a captive must be overseen by experienced professionals that understand the insurance, financial, tax and legal aspects of the captive. Because it is a regulated insurance company, our clients often prefer to have a professional third party administer the captive on a turnkey basis. Most regulators demand ongoing professional management.

SIMPLIFIED OWNERSHIP STRUCTURE
FOR A CAPTIVE INSURANCE COMPANY



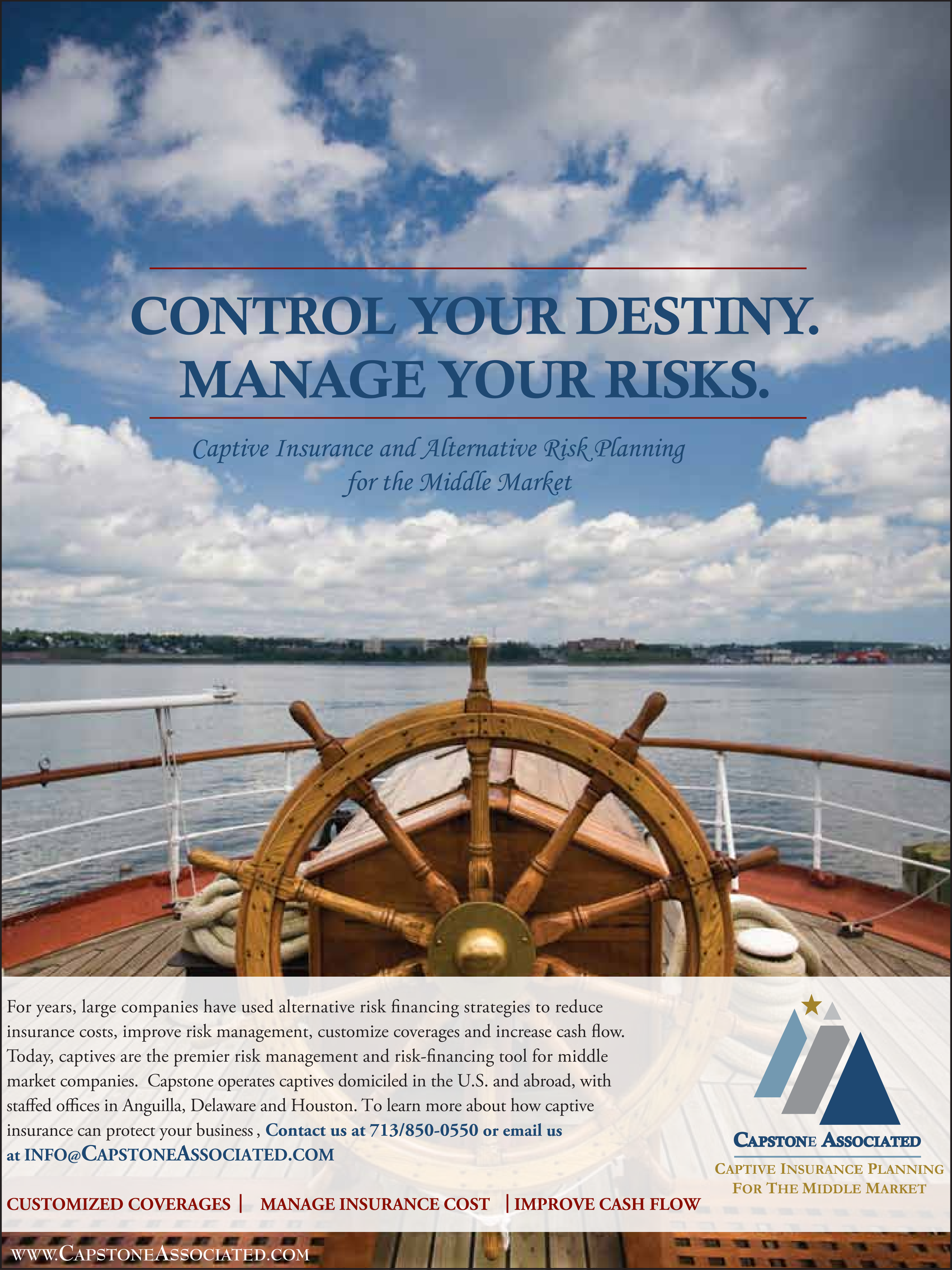
CR: Can a business owner choose what to insure against?
SF: Absolutely. A business owner can choose to insure his operating business against events where his current conventional polices fall short. Often the captive's policies dovetail with the exclusions, exceptions and carve-outs in the conventional coverages.

CR: How prolific is the use of captives in US industries?
SF: Already thousands of businesses representing industries such as manufacturing, fabrication, distribution, finance and construction, to name only a few, now participate in some type of alternative risk-planning programme to better insure the risks of its parent company. Even Google and the US government operate their own captives. The risks of the contractors excavating the remains of The World Trade Center site were born by a government sponsored captive. An estimated 50% of all property & casualty premiums are written through captives.

CR: How are premiums paid to the captive?
SF: A captive is a regulated insurance company that must first be licensed by an insurance commissioner in a US state or foreign jurisdiction. Once established, premiums are paid to the captive like any other conventional policy premiums, except instead of being paid to an outside organisation, monies are paid into the captive insurance company.

Capstone offers webinars to help business owners and their advisors learn and understand if a captive insurance company is right for them. The webinar covers how to: manage insurance costs, customise coverages, improve cash flow, retain insurance profits, protect your assets and build tax advantaged reserves for future claims.

CR: How would a business owner set up a captive?
SF: A captive insurance company must always be established with a bona fide insurance purpose, in other words, as a facility for transferring risk and protecting assets. The transaction must make economic sense. Beyond this general rule, there is a great deal of flexibility in how the captive insurance company can benefit a client. Business owners interested in forming a captive can contact us to see if their operating companies might qualify.


CONTROL YOUR DESTINY.
MANAGE YOUR RISKS.
Captive Insurance and Alternative Risk Planning
for the Middle Market
For years, large companies have used alternative risk financing strategies to reduce insurance costs, improve risk management, customize coverages and increase cash flow. Today, captives are the premier risk management and risk-financing tool for middle market companies. Capstone operates captives domiciled in the U.S. and abroad, with staffed offices in Anguilla, Delaware and Houston. To learn more about how captive insurance can protect your business, Contact us at 713/850-0550 or email us at INFO@CAPSTONEASSOCIATED.COM
CAPSTONE ASSOCIATED
CAPTIVE INSURANCE PLANNING
FOR THE MIDDLE MARKET
CUSTOMIZED COVERAGES | MANAGE INSURANCE COST | IMPROVE CASH FLOW
WWW.CAPSTONEASSOCIATED.COM