AFFORDABLE CAPTIVES

Risk Management, Asset Protection,
& Tax-Favorable Wealth Building

Captive Insurance Companies (CIC) can be the most powerful risk-mitigation/wealth-building tools available to profitable business owners. Until recently, CICs were so expensive that most businesses simply could not justify using them. With the advent of the Affordable Captives Solution, CICs are now a viable tool for most profitable businesses.

www.affordablecaptives.com

AFFORDABLE CAPTIVES

- Risk Management
- Tax Planning
- Estate Planning
- Asset Protection

What is a Captive Insurance Company (CIC)

A CIC is an insurance company established to insure the risks of its parent company or a group of companies. In the simplest form, a CIC is an organized plan of self-insurance that calculates risk, issues policies, collects premiums, pays expenses, and establishes reserves to pay future claims.

Self-Insuring Risk

Every business chooses to self-insure multiple risks that could be covered by commercial insurance. Some examples of these risks are: loss of license for professionals (doctors, lawyers, CPAs, financial planners, etc.), loss of key supplier, legal defense, or audit defense liabilities. If a business that is not insured incurs a loss because of one of the aforementioned risks, the business can sustain sometimes substantial financial loss as a consequence.

Why are captives formed?

Several reasons which include but are not limited to: 1) to protect against uninsured risks not covered by traditional insurance; 2) to control risk by setting coverage desired by the business owner; 3) greater control over claims; 4) reduce total insurance costs; 5) income tax planning; 6) wealth building; 7) estate planning; 8) asset protection.

Are CICs commonly used tools?

Yes. Over 75% of the Fortune 500 companies have CICs.

Why aren't more businesses using CICs?

In a word: Costs! Until the creation of the Affordable Captive structure, businesses needed to commit to paying annual premiums of $500,000 or more a year to make them financially viable.

What is the minimum premium to use the Affordable Captive structure?

$100,000 a year.

What tax code section is used as the basis to form a CIC?

28 U.S.C. sec. 831(b). 831(b) CICs are considered "small captives." There are other tax code sections that govern other types of CICs, but most medium-to-small businesses will use code section 831(b) when forming a CIC.

Are premiums paid to a CIC deductible?

Yes. 100% deductible by a business as an ordinary and necessary business expense.

How are premiums received by the CIC taxed as well as investment growth on reserves as they grow?

Premiums are 100% tax free when received by a CIC. Investment growth inside the CIC is taxed at the C-Corporation tax rate.

How do you mitigate the taxes levied on reserves as they grow in the CIC?

The CIC owner can have the reserves allocated to tax-free bonds, tax-efficient brokerage accounts, or cash value life insurance.

What happens after years of funding a CIC when an owner decides it is no longer needed?

It depends on the structure. With a one-owner CIC, it can be closed down (at which time under the current state of the law the owner would pay long-term capital gains taxes on the above-basis assets of the CIC). With a multiple-owner CIC, when one owner wants to end his ownership in the structure, his/her interest is redeemed; and the above-basis assets will be taxed at the long-term capital gain tax rate.

How much does it cost to set up a typical CIC?

$50,000-$75,000 for a single-owner captive.

How much is the cost for the Affordable CIC structure?

$5,750 per each $100,000 premium. If premiums of one owner exceed $800,000, the setup costs are capped at $46,850 for an international CIC and $58,850 for a domestic CIC.

What is the typical annual administration fee for a CIC?

$35,000-$50,000 a year for structures that have flat fees. For CICs that charge fees on a percentage of new premiums, the fee is 14-18% of each year's premium.

What is the annual administration fee for the Affordable CIC structure?

11-12% of new premium.

Why are costs for affordable CIC structures so much less?

Two reasons: 1) Economies of scale. Each 831(b) CIC will be set up to maximize the allowable premium at $1.2 million a year. Most CICs have annual premiums starting at $400,000 a year. Because single-owner CIC administrators are working off of premium amounts that are typically between $400,000-$600,000 (vs. $1.2 million), they keep a higher fee structure to have an economically viable structure. 2) Many CIC administrators keep their fees high because that's what the market will bear. CICs done right are such good risk-management/wealth-building tools that business owners will pay fees up to 18% of new premiums for their structures. To put it bluntly, there are not many firms in the CIC administration business; and they know it (and have chosen to keep fees higher than are needed to put forth a price-reasonable model for the CIC administrator and CIC owner). It is because of reason number two that the Affordable CIC solution was created.

Does a CIC bear 100% of the risk for the insurance coverage it provides?

No. CICs have a requirement to share its risk with others. Conservatively structured CICs share 50% or more of their risk with other similarly structured CICs. CICs are real live insurance companies that issue policies to policyholders who can have claims. A good CIC structure will risk share with a large risk pool to spread the risk among other CICs.

What is the average claims history of a typical CIC?

It varies greatly depending on the risks insured. CICs that insure non-traditional risks (traditional being auto, homeowners, E&O coverage) typically have a claims history of less than 10% a year and many of less than 5%. The bigger the risk pool the lower the risk exposure.

Where should CICs be formed?

It depends on what's important to the CIC owner(s). CICs have traditionally been set up in non-domestic jurisdictions like the BVI (British Virgin Islands) to have maximum asset protection and to minimize capitalization. Now, in excess of 25 states have enacted CIC legislation allowing them to be formed domestically.

Who has control of the money in a CIC?

Captive owners control their company, how claims are handled, and how reserves or underwriting profits are invested. Accounts are set up so that the CIC owner has total control of the money.

How long have CICs been around?

Since the 1960s.

Why have you not heard of CICs before?

Because of the high premium amounts for traditional single-owner CICs ($500,000+ a year), few advisors choose to take the time to learn about them. Large CPA and law firms are typically aware of CICs because they deal with larger clients who can economically justify using them. Now with the Affordable Captive structure, more advisors will learn about them; and, in turn, more consumers will learn about them.

Is the Affordable CIC structure a segregated-cell captive?

No. It is a traditional Section 831(b) non-segregated cell CIC.

What are the capitalization requirements to set up the Affordable CIC?

$20,000 per $100,000 of first year premium for internationally based CICs and $25,000 per $100,000 of first year premium for domestically based CICs.

What is a feasibility study, do you need one, and what do they typically cost?

A feasibility study is done by a CIC manager to determine if a business that wants to use a CIC is a good fit. It is a thorough review of the last two years tax returns combined with analyzing the risks of the business owner. This includes a preliminary determination of the types of risks that can be insured and whether the company has sufficient risk to pay premiums in the amount desired. A feasibility study is done by every quality CIC manager before taking on a client. The cost will vary depending on the administrator, type of CIC, and the types of risks being insured. Costs typically range from $10,000-$50,000+.

What is the cost of a feasibility study for the affordable CIC structure?

$1,495. This is a one-time, non-reimbursed fee.

Who is involved in the setup/formation/ongoing administration of a CIC?

<u>Actuaries</u>—one of the keys to having a successful and respected CIC is the use of a good actuary. Too many times will fly-by-night CIC managers use actuaries that do not use sound principles when determining the viable risks to insure and the fair market value of the cost to insure such risks.

<u>Attorneys</u>—law firms are part of the setup process of a CIC structure. This includes the CIC itself as well as other structures (such as a domestic or international LLC to own the interest of the CIC).

<u>Accountants/auditors</u>—tax returns must be filed appropriately, and a business typically has a local CPA who will want to review the structure from the outset to make sure it is being done properly.

<u>Managers</u>—you cannot have a compliant or well-run CIC without a good manager. A manager helps coordinate all the other advisors to help set up (licensing, etc.) and run the CIC on a day-to- day basis. This includes dealing with the risk-sharing pool and claims.

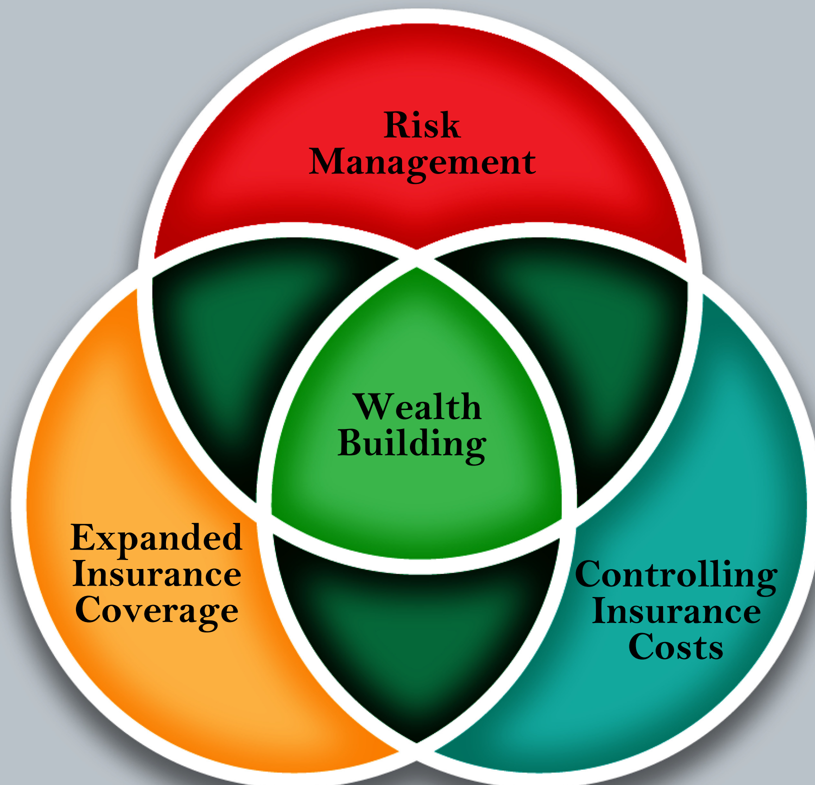
<u>Other consultants</u>—many times a CIC will have a financial advisor or insurance agent involved in the structure to give counsel as to how and where capital and reserves should be positioned to grow wealth in the CIC in a protected and tax-favorable manner.

Who typically owns the CIC?

For enhanced asset protection reasons, ownership of a CIC is typically a domestic limited liability company (LLC), international LLC, or offshore asset protection trust. For owners who have estate tax problems, the CICs interest is typically owned by an irrevocable trust.

If you own or run a profitable small-to-medium sized business, the question is: **Can you afford to pass up the benefits** of using the Affordable Captive Insurance Company Structure?

The benefits of the Affordable Captives structure:



Risk Management : CICs are formed to reduce risk. When buying traditional insurance coverage, there is no incentive to mitigate covered risks. Because a CIC is owned by the business or business owners, there is a financial incentive that will motivate a business to improve its risk-management program.

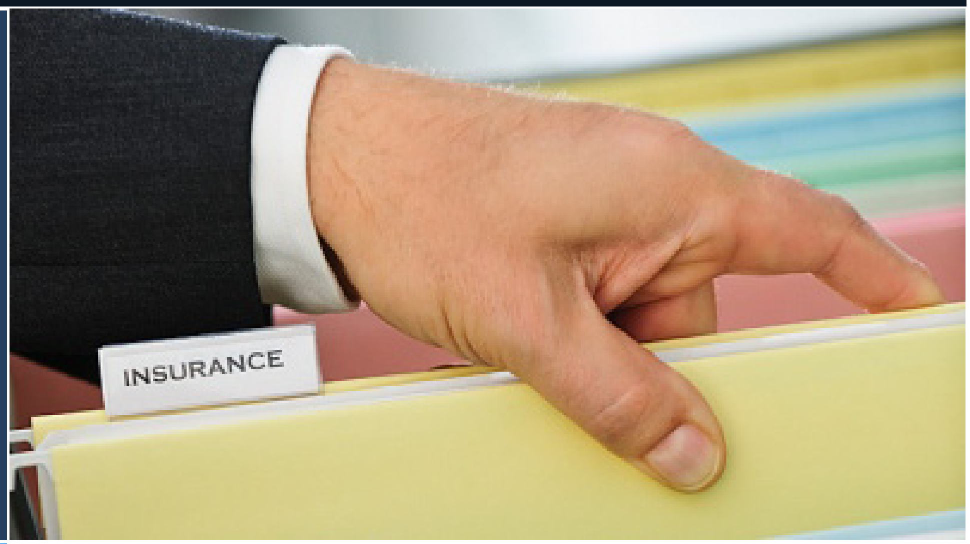
Controlling Insurance Costs : When using a CIC to provide insurance coverage, businesses are in control of the insurance costs, size of deductibles, types of coverage provided, the claims process, etc.

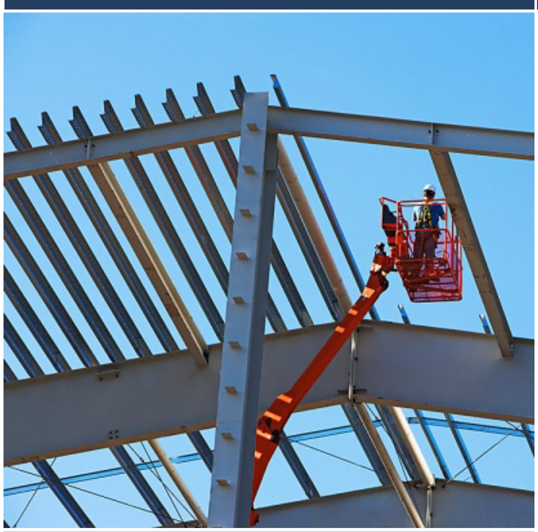
Expanding Insurance Coverage : There are dozens of insurance risks that most businesses choose to self-insure against. Defense costs and claims for uninsured risks are paid out of the cash flow of a business. With a CIC, businesses can now purchase insurance coverage for several uninsured risks and protect the financial viability of the business in the event of one or multiple claims.

Wealth Building : CICs are funded with pre-tax premium payments. With a reasonable claims history, CICs can accumulate substantial assets in a tax-favorable structure. If wholly or partially owned by an irrevocable trust, CICs can also offer tremendous estate-planning benefits.

AFFORDABLE CAPTIVES

capture the rewards of business risk





Harnessing the Power of the Affordable Captive Insurance Company Structure

How can business owners harness the power of the Affordable CIC structure?

A good starting point is to learn more about CICs by going to www.AffordableCaptives.com.

At our web site, you can learn the basics about CICs and more specifics about the Affordable CIC structure.

Find a local advisor

If you would like to speak with a local advisor about the Affordable CIC structure to determine if your business can benefit by using this unique risk-management/wealth-building tool, please e-mail info@AffordableCaptives.com

General inquiries

If you have questions about the Affordable CIC, please e-mail info@AffordableCaptives.com.