



## Department of Consumer and Business Services

### Insurance Division — 4

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## Captive Insurance Company Feasibility Study

### Purpose

This document provides a guideline for the preparation of a Captive Insurance Company Feasibility Study (hereinafter, “CICFS”). This guideline is intended to promote consistency and professional quality in the preparation and the compilation of the initial feasibility study. This guideline provides the minimum requirements of a CICFS. Any additional information that the individuals preparing this document believe is important should be included.

### Scope

Captive feasibility studies should adhere to the following format and scope:

- A. **Cover Page** – The feasibility study should have a cover page including:
  - The name of the captive insurance company
  - The names of the individuals involved in preparing the CICFS
  - The address and telephone number of the individuals preparing the CICFS
  - The date of the report
  - Signature of the actuary (or include the signature in a separate letter)
- B. **Background and Scope of the Analysis** – The following items should be included in the background and scope section with the order, language, and presentation format left to the individuals:
  - Identification of the parent or members of the proposed captive
  - Statement of why the study was undertaken
  - Summary of coverage, policy forms, lines of business, limits, deductibles, and retentions
  - Summary of source of funds (premiums, LOC, accessibility, etc.)
- C. **Summary of Recommendations** – Feasibility studies should include a summary that contains the basic findings and conclusions as well as the key assumptions underlying those findings and conclusions. Key paragraphs of the summary should reference sections, appendices, or pages of the rest of the report. The summary should include the following information:
  - Discussion of rates, rate structure, and premium level broken out by line of insurance
  - Discussion of the degree of capitalization and the level of confidence in the aggregate funding, which should include premiums and investment income
  - In the case of an association captive, a discussion of the minimum number of participants required to form a critical mass that makes the program feasible
  - Summary of results of pro-forma financial statements, including a worse-than-expected scenario demonstrating the possibility of serious financial loss or impairment
- D. **Analysis Section** – Where analysis items have been omitted, are not relevant, or are not required, their absence from the feasibility study should be noted. The following order is recommended:
  1. *Data analysis* should include studies based on estimates of expected frequency and severity of loss using available data. These estimates may be derived from: trended and developed historical loss data, outside sources of data (ISO, RAA, etc.), expertise within the firm, and judgment. It should be noted, however, that judgmental estimates should be disclosed as such and the source clearly stated. Judgmental estimates may be accepted as long as they are clearly disclosed.
  2. *Loss projections and risk margins* of expected and higher-than-expected levels of loss should be included. These projections and margins are either actuarially determined and stated as such or the methodology used is clearly documented. In all loss-projection sections, each step should be explained in terms of how and why the procedure was used. For example, how is trend and loss development handled? Are losses discounted for the time value of money?

3. *Expense budget* for the captive insurance company should be clearly discussed. In addition, the CICFS must make reference to tax issues. The tax issues should address either the state that the captive insurance company is subject to within the models or that the captive insurance company is not subject to tax consequences. Should the CICFS state that the captive insurance company is not subject to taxes of certain jurisdictions the reasons for this must be clearly documented. The division considers tax consequences to be an extremely important consideration of captive insurance company formation. Types of tax issues may include, but are not limited to, the following:
    - a. U.S. income tax - to the captive, to the owners
    - b. Excise taxes
    - c. Excess and surplus lines taxes
    - d. Other assessments or applicable taxes (i.e., residual market mechanisms)
  4. *Premiums/Funding* items (2) and (3) should be brought together in order to develop the total recommended premium for the captive.
  5. *Capitalization* is needed to cover the variability and uncertainty of expected loss levels. Therefore, a relatively extensive discussion of capitalization should be included in the CICFS. Included in the discussion should be a review of minimum participation requirements and any heuristic logic used in determining capitalization.
- E. **Pro Forma Financial Statement** – Pro forma financial models should include the following:
- An income statement and balance sheet
  - Parameters which agree with the other analyses in the CICFS
  - Include at least five years of pro forma results
  - Account for the effects of all types of taxation (or explain why there are no tax consequences)
  - Include at least one scenario worse than expected that demonstrates the consideration of possible financial impairment
  - Include a detailed explanation of each modeling assumption
  - Include general assumptions such as interest rates, year-to-year growth rates, etc.
  - Include a model showing the minimum number of participants, premiums, or capital
- F. **Other Sections** – In order to add value to the CICFS, the “other sections” area should be used to describe other areas of captive insurance in which standards have not yet been developed. These may include, but are not limited to, the following:
- Fronting
  - Rating
  - Dividend, or profit allocation system
  - Capital allocation, alternative captive techniques
  - Accessibility