

Incorporated Cell Captives

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Technical Memorandum

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TECHNICAL MEMORANDUM

INCORPORATED CELL CAPTIVES - CONCEPT

One of the hallmarks of the international financial services industry is its constant drive to create new products in response to the risk management and financial planning needs of successful businesses. The captive insurance industry, responding to the need of smaller businesses for faster set-up and more affordable administration of captive insurance companies, created the cell company structure.

In 1997, the protected cell company structure was introduced as one of the first forms of cell companies in the captive insurance industry.¹ A protected cell company is comprised of a core company with cells or sub-accounts attached to the core. The purpose of a protected cell company is to centralize certain administrative functions, while segregating the assets and liabilities of the different cells or sub-accounts of the protected cell company. This would enable each cell to engage in the business of insurance, separate and apart from the other cells. However, while the protected cell company structure has many advantages, it could present significant liability issues if the cells or sub-accounts are not treated as separate from the core. As a result, when first created, it was not clear whether the cells or sub-accounts were completely protected from the liabilities of the core.

In response to this issue, some jurisdictions enacted legislation that provides for the separate existence of the individual cells. These jurisdictions have created a captive insurance company structure known as the incorporated cell company. The incorporated cell company structure is similar to the protected cell company structure in that it involves individual cells that are attached to a core company. The difference is that, under the incorporated cell company structure, each cell is a separate legal entity that files its own articles of incorporation and obtains a separate taxpayer identification number. The hope is that this separate legal identity will protect the cells from the liabilities of the core and the other cells.

The incorporated cell company structure has two primary components. The first is the Incorporated Cell Company (“ICC”), which acts as the core. The second is the individual cells attached to the ICC and known as Incorporated Cells (“IC”). Under the incorporated cell company structure, the ICC obtains an insurance license from the jurisdiction’s insurance regulators. The ICC’s license permits ICs attached to

¹ HM Revenue & Customs, *GIM11020 - Captive Insurers* (February 22, 2013), <http://www.hmrc.gov.uk/manuals/gimanual/gim11020.htm>

the ICC to engage in the business of insurance. The ICs do not obtain an insurance license, but simply register under the ICC. It is the ability of the IC to essentially borrow the insurance license of the ICC that results in lower set-up and ongoing administration costs for the IC. In order to register under an ICC, an IC is required to execute an operating agreement with the ICC. In addition, it is common for the ICC to control a majority of the board of directors of the ICs registered under it.

INCORPORATED CELL CAPTIVES - BENEFITS

The incorporated cell company structure achieves many of the same benefits of a stand-alone captive insurance company (e.g., risk management, ownership, etc.), but at a fraction of the cost.

Pooling of Professional Support

The incorporated cell company structure permits the pooling of professional support necessary to establish and manage a captive insurance company. Typically, the ICC will retain professionals, such as insurance managers, actuaries, auditors and lawyers, who possess the experience and knowledge necessary to develop and manage a captive insurance company. Spreading the costs of these professionals among the ICC and the ICs attached to the ICC reduces the costs to the individual ICs.

Established Policy Options

Generally, an incorporated cell company statute provides that an IC can only issue policies approved by the ICC. Before an IC is even established, the ICC will have obtained an actuarial study of different types of insurance. The ICC's actuarial study will provide pricing parameters for the policy lines approved by the ICC. This means that, as long as the IC desires to issue a type of policy pre-approved and priced by the ICC, the IC will not be required to obtain its own actuarial study. This is another example of how the incorporated cell company structure reduces the set-up costs for the IC. If an IC desires to issue a type of policy not already approved and priced by the ICC, it will be required to obtain its own actuarial study at its own cost. In addition, it will be required to obtain the consent of the ICC.

Separate Legal Entities

Each IC will file articles of incorporation and have a separate legal identity. In addition, the IC's relationship with the ICC is contractual, rather than structural. As a result, as long as the IC maintains its separate corporate existence, the expectation is that the shareholders of the IC will not be liable for

the debts and obligations of the IC, including insurance claims made against the IC, or the debts and obligations of the other ICs or the ICC. In addition, the dissolution or insolvency of one IC should not affect the other ICs.

Fast Set Up

Because the ICC has already obtained an actuarial study and has approved and priced the types of insurance available to the ICs, an IC can be established much more quickly than a stand-alone captive. As long as the insurance department regulators receive complete and accurate documentation, the process can be completed in as little as 30 days.

Portability

Incorporated cell company statutes generally permit an IC to separate from its ICC and become a stand-alone captive. Under the incorporated cell company structure, an IC already has a separate legal identity. It will have filed its own articles of incorporation and will have a separate board of directors. In addition, it will maintain a separate bank account and will be required to maintain the minimum capital and surplus required by the jurisdiction. As a result, an IC should be able to convert to a stand-alone captive with less disruption than would occur in other captive insurance company structures.

INCORPORATED CELL CAPTIVES – LIMITATIONS

Investments

Because an IC is an insurance company, it may be required to pay insurance claims. In addition, an IC, like any other insurance company, will be subject to regulation by the insurance department of the jurisdiction where the IC is domiciled. In order to ensure its ability to pay claims, the insurance department will require the IC to maintain a minimum level of “reserves”. An insurance company’s reserves are that portion of its assets set aside to pay claims. Assets in excess of its reserve are considered surplus. The reserves that an IC will be required to maintain are determined by the IC’s actuary in a feasibility study and are based on anticipated claims. Because reserves support an insurance company’s ability to pay claims, they are subject to strict investment and solvency guidelines. If, at any time, the IC’s reserves do not meet the minimum requirements of the insurance department, the IC will be declared insolvent. This may result in the suspension or revocation of its registration under the ICC or the complete liquidation of the IC.

In addition to regulation by the insurance department, the IC's investment strategy may be subject to the supervision of the ICC. Typically, an ICC will limit the investment options of the IC. By limiting the ICs to pre-determined investment options, the ICC can reduce the investment costs incurred in connection with the operation of the ICs linked to it. The pre-determined investment options generally focus on growth and protection of principle. Examples of preapproved investments include brokerage accounts (with pre-approved investment managers), fixed or equity-indexed annuities, high cash-value equity-indexed life insurance and cash. Investments in real estate, mortgages, loans and factoring are commonly prohibited.

Governance

An IC is a corporation, organized under the laws of the jurisdiction where it is domiciled. It is separate and distinct from the ICC and the other ICs linked to the ICC. It is formed by filing articles of organization with its domicile and has shareholders, a board of directors and officers. Even though an IC is linked to an ICC, its insurance business is separate from the insurance business of the ICC and the other ICs.

An IC is generally required to enter into an operating agreement with the ICC. Through the operating agreement, the ICC will establish certain parameters for the operation of the IC's insurance business, such as the types of risks that can be underwritten and the investment policy of the IC.

INCORPORATED CELL CAPTIVES - IMPLEMENTATION

Feasibility Study

The first step in the process of forming an IC is to obtain a feasibility study. The feasibility study should be performed by an independent actuary who is an expert in the property and casualty insurance business. The actuary examines the nature of the business, assesses the types of risks faced by the business and determines whether these risks can best be mitigated through a captive insurance company.

As part of the study, a pro-forma analysis should be conducted, comparing the costs and benefits of insuring the risks through a captive insurance company, buying insurance in the commercial market or doing nothing.

Establishment and Administration

If a business owner desires to form an IC, they will need to engage a service provider, like RMC. The service provider will begin the process of forming the IC under the ICC that the service provider has already established. The service provider should prepare all applications required by the regulatory authority. The proposed owners and officers of the IC will be required to provide certain information and documentation in order to complete the registration process.

Once the IC's registration has been approved, the service provider should work with the IC to underwrite the risks to be insured by the IC, establish and collect premiums and issue insurance policies. The IC will then be able to invest the assets at the direction of the IC's owners (within the parameters established by the ICC).

Once the IC has been formed, the service provider should provide actuarial and administrative services to the IC. The service provider should create invoices and collect premiums. They should work with the IC's accountant to prepare and file tax returns and work with an independent auditor to prepare the financial audit that is typically required by the insurance department. In addition, the service provider should manage the operation of the IC to ensure compliance with incorporated cell company statute of the jurisdiction where the IC is domiciled.

RESOURCES

ABOUT THE AUTHOR

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Executive Vice President & Chief Actuarial Officer

Ryan joined RMC in 2007 and currently serves as the firm's Executive Vice President & Chief Actuarial Officer. His actuarial experiences range from life & annuity development to qualified retirement plans. In addition, Ryan provides actuarial consulting to a number of insurance and reinsurance companies. Ryan also sits on the board of over 20 insurance companies, including RMC Reinsurance Co. and RMC Property & Casualty Co.

Ryan is a frequent speaker at insurance, employee benefit, and risk management conferences, and has been featured as the key-note speaker at several conventions. He has authored several articles for publications and science journals.

Ryan attended Drexel University where he received a Bachelor's in Economics, a Bachelor's in Commerce Engineering, and a Master's in Engineering Management. Ryan received his Associate in Captive Insurance (ACI) designation from the International Center for Captive Insurance Education in 2013. He received his Certified Insurance Counselor (CIC) designation from the Society of Certified Insurance Counselors in 2015. In 2016, Ryan received a Certified Professional Insurance Agent (CPIA) designation from the AIMS Society.

Ryan is active in various national and local associations, including the Self-Insurance Institute of America (SIIA), the Captive Insurance Companies Association (CICA), the Risk and Insurance Management Society (RIMS), and the Insurance Professionals of Collier County (IPCC), where he won the 2015 IPCC VIP of the Year Award. Ryan is also an Affiliate of the Society of Pension Professionals & Actuaries (ASPPA).

When not traveling, Ryan enjoys fishing, running, woodworking, golf and racquetball. He grew up in Cape May Court House, NJ and currently resides in Naples, FL.

ONLINE SUPPORT INFORMATION

Customers may access support information related to captive insurance on rmcgp.com/user

IMPORTANT KNOWLEDGE BASE ARTICLES

New knowledge base articles have been posted online to assist with captive insurance company questions, as well as other areas of interest, including:

- Pension Plans & Retirement Planning
- Insurance
- Self-Insurance
- Risk Management
- Employee Benefits
- Health & Welfare Plans

INFORMATION ON ADMINISTRATIVE & CONSULTING SERVICES

For more information about RMC Group's Administrative and Consulting Services, there are three easy ways to get in contact with us.

web: www.rmcgp.com/products-services

email: rmc@rmcgp.com

call: 888.599.5553

INDUSTRY RESOURCES & GENERAL GUIDELINES

For more industry information and general guidelines on captive insurance:

Captive Insurance Companies Association (CICA):

www.cicaworld.com/Resources.aspx

Self-Insurance Institute of America (SIIA):

www.siaa.org/i4a/doctrinary/

The Risk Management Society (RIMS):

www.rims.org/resources/ERM/Pages/default.aspx

ABOUT RMC GROUP

RMC Group is a global leader in providing insurance, risk management, and retirement solutions to help consumers and organizations secure and manage their risk-driven world. Our services protect against more risks at more points, more completely and efficiently, enabling confidence wherever risk is located. Headquartered in Naples, Florida, RMC Group has operations in 5 countries and our presence can be felt around the world.

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