DEDUCTIBLE BUY-BACK PROGRAMS

CAPTIVE SOLUTION PRODUCT INFORMATION

OVERVIEW OF DEDUCTIBLE BUY-BACK PROGRAMS

In the current insurance marketplace it has become common for companies who retain large deductibles on their commercial property and casualty programs to consider alternative risk financing specifically where a captive can be a solution. There are many reasons why a captive is a viable option for financing the retained deductible with a program.

Some of the considerations for utilizing a captive deductible buy-back program include:

- Stabilize the cost of risk;
- Company balance sheet protection;
- Accelerated tax deduction; (tax advice should be sought)
- Formal accounting for risk financed in a captive;
- Ability to build a financial mechanism for taking more risk;
- Capture underwriting profits;
- Breadth and availability of coverage; and
- Favorable dealings with the excess insurance markets.

THE STANDARD COMMERCIAL DEDUCTIBLE PROGRAM

With a standard commercial deductible program, the carrier provides a policy with a certain ground up limit and certain per occurrence deductible – perhaps with an aggregate to that deductible obligation. The insured pays a premium to the carrier for the excess risk transfer and the aggregate cover, while the losses that fall under the deductible are to be paid directly by the insured.

The deductible can vary depending upon the insured's risk appetite and the commercial carrier's requirements. The commercial carrier will provide risk transfer for the deductible layer once the insured has paid a certain dollar amount in the losses within the deductible up to an aggregate. With this scenario, the commercial carrier still provides the suite of services similar to a guaranteed cost program, first dollar program, where they will issue certificates of insurance, accept fiduciary responsibility for the all losses (as viewed by outside parties) including those falling within the deductible, all posting notices, fulfilling all regulatory requirements as a workers compensation carrier, and working to handle all claims with a claims administrator.

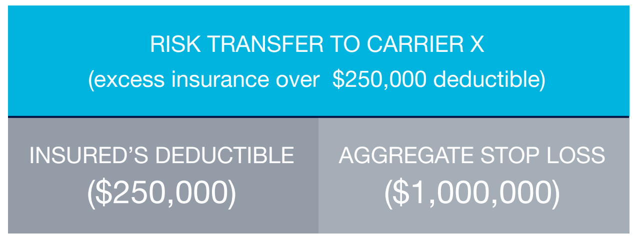
FOR FURTHER INFORMATION REGARDING DEDUCTIBLE BUY-BACK CAPTIVE SOLUTIONS PLEASE CONTACT:

ANNE MARIE TOWLE, CPA
EVP, Practice Leader
Captive Consulting
317.922.4390
annemarie_towle@jltimusa.com

An example of this type of program:

Carrier X offers a workers compensation policy with a statutory limit and a $250,000 per occurrence deductible and a $1,000,000 aggregate. Essentially meaning the insured must pay all losses up to the $250,000 limit for the deductible for each occurrence with a maximum of $1,000,000 in the aggregate for all loses. Carrier X will then pay all losses (including first dollar within the deductible) once the insured has reached the aggregate of $1,000,000. With the numbers illustrated here, the $1,000,000 aggregate must be paid from the insured's current operating income. Over the course of a year, several months could be substantial depending upon the claim activity and impact the overall financials of the insured. The claim liability may take one year or many years to be paid out or closed.

Commercial Deductible Program Chart



THE CAPTIVE DEDUCTIBLE BUY-BACK PROGRAM

Utilizing a captive deductible buy-back program would not change the program/policy with Carrier X. The main difference is the insured's deductible liabilities would now be financed through a premium paid to a captive as opposed to being paid from the insured's operating income in a given year.

The insured establishes a captive insurance company or would rent a cell or join a group captive to finance their deductible program. The captive issues the policy to the insured with limits matching the deductibles on the excess policy issued by the carrier. In exchange for the captive issuing the deductible buy-back policy, the insured pays a premium to the captive. The premium funds are utilized in the following manner:

- to pay the losses incurred within the deductible limits;
- to pay operating expenses of the captive company;
- possible source of collateral provided to the carrier who issues the excess deductible policy; and
- Possible risk management and loss control programs.

Over time, any surplus (profits) in funding the captive could be used to finance additional risk lines, dispersed to the beneficial owners of the captive, enhance risk management and loss control programs or increase the deductible program.
The premium paid to the captive is invested typically with a duration matching investment portfolio and the investment income is earned by the captive.

Consideration is given to a variety of factors when developing a premium for a deductible buy-back program.

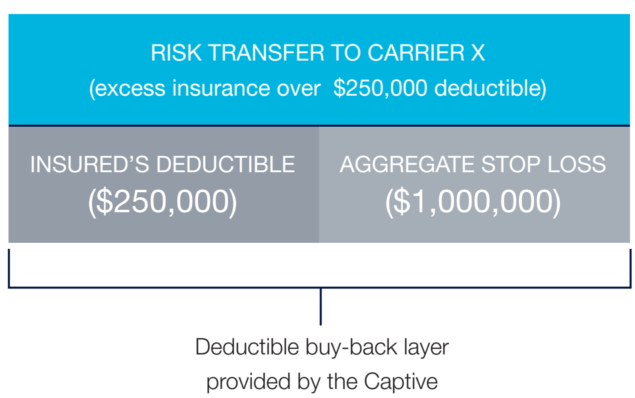
The factors include:

- Expected loss pick given by the excess carrier;
- Actuarial study results for loss pick;
- The limits provided by the deductible buy-back program;
- Collateral requirements of excess carrier;
- Historical premiums for similar liabilities; and
- Intent of insured for building surplus in captive and managing cash flow.

An example of this type of program:

Carrier X offers a workers compensation policy with a statutory limit and a $250,000 per occurrence deductible and a $1,000,000 aggregate to an insured who owns a captive company. The excess carrier X issues a deductible policy to the insured and the captive issues a deductible buy-back policy to the insured for the deductible limits.

Captive Deductible Buy – back Program Chart



TYPES OF CAPTIVE OPTIONS FOR DEDUCTIBLE BUY BACK PROGRAM

1 SINGLE PARENT CAPTIVE
Typically larger companies

2 GROUP OR ASSOCIATION CAPTIVES
Typically affinity or smaller companies

3 CELL CAPTIVES
Typically smaller companies

CONSIDERATIONS IN THE CAPTIVE EXPLORATION PROCESS

Exploring the best option for your organization entails understanding your total cost of risk and risk appetite. Some of the considerations prior to undertaking the captive path should be:

- The standard minimum levels of premium required for a captive, albeit a single parent, group or cell captive;
- The financial, operational and management aspects of a feasibility, incorporation, on-going costs and cash flow for a captive program; and
- The dedication of internal stakeholders in the entire captive development process.

SUMMARY

Ideal captive candidates for deductible buy-back programs are those companies that are willing to share the risks and rewards of funding the deductible liability while proactively managing the losses for the best cost containment. A benefit of captive participation is having improved access to data and an increased ability to analyze and change risk retention over time and improve outcomes. Incorporating proactive risk management strategies to your deductible drivers can enhance organizational efficiencies and positive financial benefits.

OUR BUSINESS PHILOSOPHY

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Collaboration

Accountability

Quality and Timeliness

Administrative Efficiency

Creativity

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JLT Insurance Management
350 Madison Ave.7th Floor
New York, NY 10017
www.im.jlt.com

A member of the Jardine Lloyd Thompson Group. Registered Office: The St Botolph Building,138 Houndsditch, London EC3A 7AW. Registered in England No. 01536540.
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