FAQ About
Captive Insurance Companies
and the District of Columbia

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Q: What is a captive?
A: A captive insurance company is generally defined as an insurance company owned and controlled by its insureds. The captive's primary purpose is to insure the risks of its owners. It issues policies, buys reinsurance, pays claims and invests premiums similar to a traditional insurance company.

Q: Why should I form a captive?
A: There are many advantages to insuring risks through a captive insurance program as well as disadvantages in terms of risk and committment. Some commonly cited advantages include:

- Tailored coverage - The captive can custom-write a policy to fit the needs of its insureds, even when such coverages are unavailable or prohibitively expensive in the commercial market;
- Pricing stability - Stable loss experience results in stable premiums. Since the captive insures only the risks of its owners, broad market conditions that result in fluctuations to premiums may not affect your captive insurance program;
- Direct access to the reinsurance market - The captive can negotiate directly with the reinsurance market thereby avoiding commissions charged by commercial carriers;
- Greater control over claims - Captive insurance, essentially self-insurance, provides financial incentives to control claims costs through proactive risk management;
- Accumulation of investment income - The captive receives and ivests premium payments until such a time when those funds are needed to pay claims, operating expenses or dividends.

Q: What types of captives can be formed in the District of Columbia?
A: The District's captive law provides for the following captive forms:

- Pure captives - A captive insuring only the risks of its parent and affiliated companies;
- Association captives - A captive that insures the risks of the member organizations of an association and the affiliated companies of those members;
- Agency captives - A captive that is owned by an insurance agency or brokerage and that only insures risks of policies that are placed by or through the agency or brokerage;

- Branch captives - An alien (i.e. foreign) captive licensed to transact insurance in the District through a business unit with a principal place of business in the District;
- Sponsored captive (protected cell captive) - A captive owned by an insurance company that insures risks of separate participants through the use of protected cells;
- Rental captives - A captive formed to contract with policyholders or associations to insure the risks of such policyholders or associations.

Q: What types of insurance can captives write?
A: Captives are generally restricted to writing only commerical lines of coverage such as commercial property, auto liability, general liability, professional liability, and employers' liability. Many captives also insure workers compensation; however, this line must generally be written through a commercially licensed insurer and assumed by the captive.

Q: What is a risk retention group (RRG)?
A: A risk retention group is a captive insurance company organized for the primary purpose of insuring liability exposures of its group members. Members of the RRG must be engaged in similar business activities (e.g., doctors seeking medical malpractice insurance).

Q: What is a feasibility study?
A: The feasibility study, generally prepared by a consulting actuary, is documentation of how the captive program will operate and is a required element of the captive application. The study is often the pivotal piece of information used to decide whether to or not to proceed with the formation of the captive. The study may include both a written summary of the business plan and five years worth of projected financial results. Those interested in forming a captive will need to accumulate three to five years worth of past premium and claims data as well as prospective information related to the insurance risks the captive is anticipated to write.

Q: What involvement will I have in operating the captive?
A: Many of the day-to-day operations of the captive, including accounting, regulatory compliance and routine claims handling are typically handled by contracted service providers. However, the ultimate responsibility for management rests with the captive's board of directors. Management must provide direction, coordinate the work of contracted services providers, ensure that loss control programs are executed and attend board meetings, among other responsibilies. Appropriate management participation is critical to achieving success in a captive program.

Q: What is a captive manager?
A: A captive manager is a contracted service provider that specializes in running the day-to-day operations of captive insurers. The captive manager will often perform the accounting function, interface with the DISR on regulatory issues and provide general consulting assistance. A captive manager can also be helpful in steering management

through the captive formation process. Go to www.disr.dc.gov for a listing of approved captive managers.

Q: What services do actuaries perform?
A: An actuary experienced in captive programs can assist in the formation of a captive through preparation of the feasibility study, in determining the appropriate premium to charge and recommending appropriate reinsurance coverage. The captive must also engage an actuary to perform an annual estimate of the captive's liability for future claims.

Q: What is a fronting company?
A: A commercially licensed insurance carrier that issues a policy and reinsures all or a substantial part of the risk to another carrier such as a captive.

Q: Will my captive have to use a fronting company to issue insurance policies?
A: Certain types of coverages require evidence of insurance from admitted insurers. In addition, some insureds may be required to show evidence of insurance from a highly-rated carrier.

Q: What types of investments are captives allowed to use?
A: A pure captive must file a summary of the types of assets to be held with the DISR and alert the Commissioner of any deviations from that plan. Association, rental and agency captives must comply with the investment regulations applicable to commercial insurers domiciled in the District of Columbia (section 18, chapter 2 of the Fire and Casualty Act).

Q: Does the captive get to keep its investment income?
A: Yes, the captive retains all of the income earned on its investments and can use that revenue for any purpose required. The captive retains the risk of default and depreciation on its investments as well.

Q: Does a captive pay income taxes?
A: Yes and no. A captive insurance company is required to file a federal income tax return but generally is not subject to state income taxes. The federal rules for taxing captive insurance programs are complex and professional advice is often important for making appropriate tax elections.

Q: Can a state guaranty fund assess captives who write business in their stat?
A: No. Captives are exempt from state guaranty fund assessments.

Q: Where can I find more information of captive insruance?
A: A variety of good information on captives is available on the Web including:

- www.disr.dc.gov
- www.dccaptives.org
- www.captive.com

- www.captiveassociation.com
- www.captiveguru.com
- www.rrr.com
- www.irmi.com

Q: What information is required to accompany the captive application?
A: The application must include the following:

- Application checklist;
- Business plan summary;
- Bylaws, articles of incorporation and participation or shareholder agreements;
- Captive manager and other service provider agreements;
- Application fee ($500) and certificate fee ($300)
- Detailed plan of operations (feasibility study);
- Biographical affidavits for officers, directors and legal counsel.

Q: What are the minimum capital and surplus requirements in the District of Columbia?
A: The statutory minimum capital may be required based on the volume and type of risk to be retained. An actuary or captive manager will be helpful in determining an appropriate level of capital to maintain.

Pure Captive - $100,000 paid in capital - $150,000 surplus - $250,000 total
Association Captive (stock) - $200,000 paid in capital - $300,000 surplus - $500,000 total
Association Captive (mutual) - $200,000 paid in capital - $500,000 surplus - $700,000 total
Agency, Rental or Sponsored Captive - $300,000 paid in capital - $300,000 surplus - $600,000 total

Q: What are the common sources of formation capital?
A: Capital, either in the form of cash or an approved letter of credit, is often funded by the owner(s), but may also be obtained through assessments on the individual insureds.

Q: Can I use a letter of credit to capitalize the captive?
A: Yes, the District's captive law allows for a letter of credit as evidence of the formation capital.

Q: What fees are involved in setting up a captive in the District of Columbia?
A: A non-refundable fee of $500 is required with the application and a licensing fee of $300 will be assessed upon approval of the application. The Commissioner may require the applicant to retain independent expertise to assist in the review of the application.

The costs of professional services to complete the application, feasibility study and incorporate the entity can vary significantly based on the type of captive, the nature of the risks and the complexity of the program. In our experience, we have seen organizational costs vary between $10,000 and $200,000.

Q: What is underwriting?
A: Underwriting is the process of selecting and rating (i.e. pricing) the risks to insure.

Q: What is reinsurance?
A: "Insuring the insurer." A form of insurance whereby one insurer agrees to indemnify another insurer for losses resulting from retained risks. Reinsurance is very common in captive programs and can take a variety of forms including:

- Quota share reinsurance - the captive and the reinsurer agree to split premiums and losses proportionally (e.g. 50/50 split);
- Excess of loss - the reinsurer agrees to reimburse the captive for claims costs over a specified amount (e.g. individual claims over $100,000).

Q: What is the difference between gross written premium and net written premium?
A: Gross written premium represents the consideration charged to the insured. When the captive shares risk with a reinsurer, part of the gross premium is paid to the reinsurer. The remaining premium (i.e. gross less reinsurance premium) represents the net written premium.

Q: How should I decide what reinsurance programs are appropriate for my captive?
A: It is very important to consult someon experienced in forming captive programs to select an appropriate reinsurance program for your captive. Actuaries and captive managers may be valuable resources in designing the reinsurance program as well as contracting with reinsurers.

Q: What are premium taxes?
A: Captive domiciles each charge a tax on the amount of premium written or assumed by the captive. The District's tax rates can be found at www.disr.dc.gov.

Q: How does a captive settle claims
A: Claims against captive insurance policies are settled essentially in the same manner as commercial policies. Often, captive programs are structured so that the fronting carrier settles the claims. In other cases, the captive may settle claims directly or through use of service providers (i.e. insurance adjustment firms and attorneys).

Q: Who should I contact at the DISR to talk about forming a captive?
A: Your first call should be directly to Mr. Bill White, Director, of Captive Operations, to set