Captive Insurance Companies
And
Employee Benefits

Over two years ago Columbia Energy Corporation applied for a prohibited transaction exemption from the Department of Labor (DOL). That means, they wanted a financial transaction involving one or more of their ERISA qualified employee benefit plans to occur between their firm and Columbia Insurance Corporation which is a wholly owned captive insurance company. (A captive insurance company is only allowed to write insurance coverage for the parent and related companies). With our help, the first ever exemption was granted about one year ago. Today there continues to be a great deal of "talk on the street" about moving employee benefits into captive insurance companies. However, there appears to be little action.

One of the benefits of this type of transaction is, the potential for a substantially improved tax position of the non-employee benefit risks insured by the captive because of the presence of the employee benefits within the captive. Others include reduced costs, centralized risk management, and better coverage. However, there are some additional costs imposed by the DOL.

The DOL required two additional costs. First, Beginning in the initial year of the transaction, there must be an immediate benefit to The Plan's participants and beneficiaries in the form of increased benefits or lower premiums as a result of the proposed transaction. The requirement does not state how large the benefit improvement or the employee contribution reduction must be. Presumably, it should not be minor. It probably needs to be material. We certainly cannot speak for the DOL, but many accountants, actuaries, and risk managers believe that an added value in excess of 5% would be considered material. . (Columbia Energy increased benefits by more than 25%)

Second, there must be an independent fiduciary appointed to review the transaction and represent the interests of the plan participants. For Columbia Energy I am the independent fiduciary. To be considered independent, the fiduciary must meet certain requirements outlined by the DOL. For example, to be considered independent the fiduciary and any entity affiliated with the fiduciary (employer, spouse, subsidiary, partner, etc.) cannot be an officer, director, employee, or partner of any party to the transaction. There is also a 5% test whereby the fiduciary and any affiliate of the fiduciary cannot derive more than 5% of their revenue from any party to the transaction

The independent fiduciary has a number of specific items that the DOL wants them to report on. Two specific ones require that the independent fiduciary certify that:

- the formula used to calculate premiums for The Plan must be similar to formulae used by other insurers providing coverage under similar programs.
- the premium charge calculated under the formula must be reasonable and within the range charged by the marketplace providing similar coverage under comparable programs.

These two items require the independent fiduciary to have the expertise to review the pricing. Further the independent fiduciary will need to have a working knowledge of the marketplace. Some arrangements involving the captive will require that the independent fiduciary have additional knowledge concerning the funding of self funded plans and knowledge of the reinsurance market.

There are three further requirements that require ongoing expense. They are:

- The Captive must undergo an examination by an independent certified public accounting firm.
- An actuarial review of The Plan's reserves must be conducted annually by an independent firm of actuaries and reported to the appropriate regulatory authority.
- The Captive must be a US domiciled captive or branch captive.

For many captives and plans, these requirements have been ongoing and present no additional requirements. However, there may be many self-funded plans where the requirement of an independent actuarial review of the reserves will present a new task for the plan. And there are many offshore captives where either a branch captive needs to be set up or the domicile would need to be transferred.

Setting up a captive insurance company solely to move qualified employee benefits into it probably is not financially viable. However, the use of a captive insurance company for all of a companies business and financial risks could prove worthwhile and provide the catalyst to cash in on the benefits of including the qualified employee benefits programs in the captive.

What does this mean to the company that is evaluating moving some or all of their qualified employee benefits into their Captive? First, determine your goals for making the move. Are you looking for more control over your risk? Looking

to reduce costs? Or maybe looking to make capital more effective? Make sure your goals are attainable and are consistent with those of the entire organization.

Second, look before you leap. Determine the costs, find the experts you need, and analyze those costs against your goals to determine if the achievement of those goals is worth the cost.

Finally, once you start, monitor your results and cost and use this information to manage the process to meet your goals.