Cell Captives

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Cell Captives

PART ONE

BILL BARTLETT, BARTLETT ACTUARIAL GROUP

JOEL CHANSKY, MILLIMAN
Agenda

- What are cell captives?
- How do they differ from non-cell captives?
- History
- Types of cells
What are Cell Captives?

- A single legal entity comprised of a “core” and an indefinite number of segregated parts or “cells”
- Formed by a “sponsor”
- Sponsor manages cell captive through a Board of Directors
- Sponsor provides minimum regulatory and operating capital (the core)
What are Cell Captives?

- Individual cells are kept legally separate from each other.
- Each cell has dedicated assets and liabilities ascribed to it, and the assets of an individual cell cannot be used to meet the liabilities of any other cell.
- Each cell is completely independent from the other cells, as well as from the core. The activities of one cell have no bearing on the other cells. Each cell is identified by a unique name.
How Cell Captives Differ From Non-Cell Captives

- Risks within each cell are legally segregated from the other cells. In a non-cell captive, all business is “co-mingled”
- Generally, lower expenses for owner of a cell in a cell captive than the administration costs of owning a non-cell captive
- A cell can be quicker and easier to set up
- Interests of sponsor do not have to coincide in all areas with owners of each cell
- Typically less of a time commitment for a cell owner since Board of Directors of cell captive provide majority of administrative and management activities (except for incorporated cells)
A Cell Captive is not a Group Captive

- Cells don’t share risk with each other.
- They don’t have to have common coverages.
- They aren’t required to maintain identical retentions or aggregates.
- They don’t cross govern each other.
History

- Cell captives have evolved over time
- Name / laws / structure for a cell captive varies by domicile
- Earliest roots started with offshore rent-a-captives (Bermuda in 1970s)
  - Rent-a-captive is a captive owned by an outside organization and open to participants for a fee. Members “rent” licenses and capital from the rent-a-captive owner. Participants are contractually segregated. All of the contracts are tied together through a participation agreement which essentially says that the facility will account separately for each client’s premium, losses, and investment income and will also include an indemnity in favor of the facility should losses exceed the amount of funds available in the cell. This indemnity is usually backed by collateral.
- Since then, many domiciles (both offshore and onshore) have enacted legislation for cell captives, which are offshoots of the rent-a-captive concept
History

• First offshore domiciles
  o 1991 – Bermuda – Separate Accounts Co.
  o 1996 – Bahamas – Segregated Accounts Co.
  o 1996 – Jersey – Protected Cell Co.
  o 1997 – Guam – Protected Cell Co.
  o 1997 – Guernsey – Protected Cell Co.
  o Etc.
History

• First onshore domiciles
  o 1999 – Vermont – Sponsored Captive Insurance Co.
  o 2000 – D.C. – Protected Cell Co. / Incorporated Cell Captive
  o 2000 – South Carolina – Protected Cell Insurance Co.
  o 2001 – Arkansas – Sponsored Captive Insurance Co.
  o Etc.
History

• More recent developments
  o Incorporated cells
    ▪ DC (2004)
    ▪ Jersey (2005)
    ▪ Guernsey (2006)
    ▪ St. Lucia (2007)
    ▪ Vanuatu (2009)
    ▪ Montana (2011)
    ▪ Tennessee (2011)
    ▪ Vermont (2011)
    ▪ Missouri (2013)
    ▪ North Carolina (2013)
  o Series LLC
    ▪ Delaware (2005)
    ▪ Nevada (2005)
    ▪ Montana (2013)
# Current Domiciles – Offshore

<table>
<thead>
<tr>
<th>Domicile</th>
<th>Cell Type</th>
<th>Date Cell Legislation Passed</th>
<th># of Cell Companies*</th>
<th># of Individual Active Cells*</th>
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<td>5</td>
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</tbody>
</table>

*Source: 2013 Captive Review Cell Company Guide
# Current Domiciles – Onshore

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<th># of Cell Companies*</th>
<th># of Individual Active Cells*</th>
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<td><strong>US Onshore</strong></td>
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<td>Delaware</td>
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<td>13 cells; 371 series units</td>
<td>9 cells; 353 series units</td>
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<td>West Virginia</td>
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</tbody>
</table>

* Source: 2013 Captive Review Cell Company Guide
Types of Cells

- **Protected**: Similar to a rent-a-captive, except that a company rents a specific cell in the captive, rather than just space, and the capital and assets for each cell are legally segregated from one another. A protected cell captive is a single legal entity. The majority of the domiciles currently only offer protected cell legislation.

- **Incorporated**: Similar to a protected cell, except that each cell is individually incorporated. Thus, each incorporated cell has its own legal identity, as well as its own Articles of Incorporation, By-laws and Board of Directors.

- **Series LLC**: Similar to a protected cell, but cells are serial business units or “SBUs”. SBUs are not subject to premium tax, and the Series LLC structure allows for efficiencies from the sharing of other administrative and service provider expenses. A series LLC captive may also be designed for simpler administration than a protected cell captive. For example, one annual meeting of a single board of managers could satisfy the minimum governance requirements of the core LLC, as well as its SBUs.

**Note**: Onshore, captives that allow protected and/or incorporated cells are referred to as *Sponsored Captive Insurance Companies* in many domiciles.
Agenda

- Current cell legislation and regulations
- Cell formation requirements
- Cells licensed / in pipelines
- Roles of a cell captive
- Regulator advice on forming cells
Current Cell Legislation

- Missouri
  - §379.1351 RSMO allows for sponsored cell captives
  - Requires $500,000 in capital & surplus
  - Sponsor may be any person approved by the director
  - Participants may be association, corporation, LLC, partnership, trust, etc.

- Utah
  - Utah 31A-37 allows for sponsored cell captives
  - Requires $500,000 capital & $500,000 surplus
  - Sponsor may be insurer, reinsurer, captive, etc.
  - Participants may be association, corporation, etc.

- Arizona
  - A.R.S. 20-1098.05 allows for protected cell captives
  - Requires $500,000 in capital & surplus
  - Participants may be association, corporation, LLC, partnership, trust, etc.
Cell Formation Requirements

- Missouri
  - Application forms and fee ($7,500)
  - Pro forma financials, business plan
  - Other factors required by commissioner
    - How loss and expense experience will be accounted
    - Sample contracts
    - Evidence that expenses are allocated fair & equitably
    - Financial records available for inspection & examination

- Utah
  - Application forms and fee ($200)
  - Pro forma financials, business plan
  - Other factors required by commissioner
  - Separate section in audit and actuarial reports
Cells Licensed / In Pipeline

- **Missouri**
  - Currently no licensed sponsored captives

- **Utah**
  - Four licensed sponsored captives
    - Two owned by captive management firms
    - One owned by medical services holding company
    - One owned by insurance brokerage holding company
  - 61 licensed cells (minus 3 dissolved)

- **Arizona**
  - One licensed sponsored captive with only one cell
Roles of Cell Captives & Advantages

- Incubator to pure captive
- Smaller business – portal to ART
  - Deductibles
  - G/L gaps
  - Reinsurance
- Helps insulate the assets and liabilities of independent insured's
- Ensures individual cell assets will remain secure and protected from creditors of other cells or sponsor
- Guards against harmful effects of adverse selection, losses and underwriting by creating a regulatory and accounting wall around individual cells
- Less Expensive (organization, capitalization & cost sharing of service providers)
Who Uses Cells

- Most of today’s cell growth tends to be profit center focused:
  - Insurance company owned
  - Insurance produced owned/Captive service providers
  - Professional service providers
  - Associations
  - Entrepreneurs
Advice on Cell Formation Participation Agreement

- Capital requirements
- Reinsurance and fronting relationships
- Premium amounts and payment dates
- Providers and services to be provided
- Voting rights
- Pooling
- Meetings, communications, notifications
Advice on Cell Formation

- Follow domicile law
- Separate account for each cell
- Experienced and knowledgeable:
  - Sponsor
  - Captive manager
  - Regulator
- Insurance purpose
- Insurance perspective
QUESTIONS OR COMMENTS

Moderator: David Dimit, MBA – MO Captive Insurance Association

A BIG THANKS TO OUR EXPERT PANELISTS

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Dept of Insurance