

Patent Pending

TRANSURANCE FOR CAPTIVES

By L. Ware Preston, III and Bruce B. Thomas

Many of the benefits that Transurance affords buyers and sellers of commercial insurance also apply to participants in the alternative market. This is particularly true for those companies who own captive insurance companies.

One of the most important functions of a captive is to allow affiliates to retain risk and buy insurance that reflects each company's specific financial objectives and its capacity to manage volatility. This varies significantly between subsidiaries of a large corporation and even more so between the individual subsidiaries and the corporation as a whole. Captives enable corporations to purchase insurance from the commercial market that maximizes value of insurance at the corporate level without unduly constraining the insurance programs of the corporation's individual subsidiaries.

Transurance enhances the benefits a captive provides by permitting it to offer its affiliates insurance to cover collateral losses, with minimal additional transaction cost. A Transurance policy defines loss coverage as a functional relationship to the losses that will be paid by a traditional insurance policy. This function may specify a fixed amount, some proportion of the losses paid under the traditional policy, or some other non-proportional relationship.

In the case of proportional Transurance, essentially all of the hard work has been done. Assume, for example, that an affiliate wants to buy a 20% proportional Transurance policy. It is just a matter of math and a little bit of administration. The captive bills the subsidiaries for an additional 20% of the premium, adjusts its reserves to reflect the additional liability for 20% of paid losses, and pays the subsidiary an additional 20% of in the event of a claim. Moreover, the Transurance premium may be discounted to share the transaction expense savings between the captive and its affiliate.

Captive insurance companies, if properly structured and managed, yield the tax benefits of insurance. Whatever tax benefits the captive creates may be magnified by Transurance. For example, if a captive provides primary casualty insurance for a premium of \$10 million, then, keeping with the example above, the Transurance premium would be \$2 million. This has the effect of accelerating the deduction for collateral losses relative to taking deductions for collateral losses when paid, as would be the case if collateral losses are not insured. As with traditional insurance, the tax benefit varies with the amount of losses and reserves held for those losses, the time it takes for losses to be paid out, the corporate tax rate, and the interest rate or after-tax corporate discount rate. The same applies to Transurance.

The only additional step that captives need to take to write Transurance for their affiliates is to obtain a license from Risk Innovations, LLC to use these business methods. Patents have been filed to protect the use of the business methods required to write Transurance. If you are interested in getting a license or want more information, please contact us.