

Integrating US Risks For Canadian Parent Corporations

Canadian businesses and organizations with US-based risks (such as branch offices, subsidiaries, products shipped, and liabilities in general in the United States) would not be surprised to learn that the US is considered the most litigious nation in the world. Direct result: most litigious = most expensive insurance in the world.

These Canadian businesses may be able to use a captive insurance company to recapture profit for all of their risks, including those liabilities presenting themselves south of the lower Mainland. Result:

1. greater claims control;
2. customized coverage;
3. profit potential;
4. budget consistency;
5. reinsurance access
6. group/pool/association/franchisor benefits; and
7. maybe even some US tax benefits.

We will try and summarize a few of these attributes below.

For our purposes this brief article attempts to introduce Canadian corporations and their service providers to some of the traits of US-centric risks that have and could be employed by Canadians via use of a captive insurance vehicle. As an American law firm operating nationwide and in almost all of the leading domiciles for formation of captive insurance companies in the USA and abroad, we can only give an outsider's view of some of the immediate distinctions between US and Canadian risks.

Stated above; the obvious one is that the general price of insurance is much, much lower in Canada than the US. Generally speaking, the USA has been loath to adopt tort caps or other mechanisms to limit damages in a tort suit that we understand may help to reduce costs in various provinces. Moreover, each state in the US has its own set of insurance rules. This in effect creates one country with seemingly 50+ different regulators, with different sets of laws. The regulatory red tape adds to costs, not to mention different litigation costs. For example, one state may have expansive worker's compensation benefits (driving the premiums, well North), whereas another state may be more interested in managing claims and returning injured workers to work. One state may have a tendency for juries to have huge judgments and others to be more restrictive. For tort differences, there are some states, primarily in the sunnier climes which have a robust plaintiff's bar looking to sue anyone for any perceived problem.

Proof is in the billboard ads when you are driving on vacation – frequency of suits, even meritless ones, drives defense costs, well, also North.

Another big difference is in many Provinces, the insurance is monopolized by the government – such as for worker’s compensation. In the United States, only four states provide worker’s compensation. Free market competition is the norm for many of the other states. This can lead to higher and lower prices varying by each line in each state. For the other 46 – worker’s compensation is usually the second biggest employer expense after wages (and well before taxes and health insurance). Result is patchwork of pricing and myriad differences in benefits. Oh, and health insurance is also privatized in the US. But this is somewhat difficult to put into a captive (beyond the scope of this article – call us to discuss more).

Ok, so you have US-based workers or liabilities and want to explore how you can try and recoup some of that expense. Here are a few of the reasons (stated above) that we have seen captives formed:

1. Claims Control. By creating your own captive insurance company you may be able to more precisely direct counsel and claims adjusters and also have input into whether to litigate or settle depending upon your decision;
2. Customized Coverage. Manuscript policies and tailored limits based on your preferences and not a take-it-or-leave it approach;
3. Profit. This is the big one. Insurance companies have substantial overhead. By directly paying your own premium to your own captive you can eliminate certain expenses and use these to capture profit or potentially lower your premium. Profit is never guaranteed, but if your risks are better than the average, and your loss/safety and claims controls are in place, it is not unheard of for captive owners to capture a large proportion of their insurance costs back.
4. Budget consistency. Insurance costs vary every year. Constituents (shareholders, parent corporations, taxpayers – really all stakeholders) want to have consistent pricing for their insurance. Owning your own captive can help to smooth out the drastic rises and dips and allow for a predictable cost to be paid to your captive (which as in #3 above, turns into profit);
5. Reinsurance access. Direct, wholesale reinsurance purchases to protect you and the captive from severity and frequency losses. The savings can be substantial;
6. Group/Pool/Association/Franchisor Benefits. Small to mid-sized entities can be grouped together to purchase insurance on a bulk basis. Result can be savings, customized coverage, and support of the organization bringing them together. In fact, we have been involved in many situations where the group/pool/association/franchisor establish the captive, and this sponsorship equates to compensation. Typically a win-win for everyone. The ultimate insured gets great coverage for a wonderful price, the sponsoring organization offers more benefits creating more cohesion and a revenue stream. But every deal is different – so give us a ring at www.KregerBeeghly.com to bounce the idea off of us;
7. Possible US tax benefits. If you have US operations you probably have US tax obligations. A properly set up captive insurance company might achieve a couple of tax benefits for the [ultimate] Canadian parent, including potentially deducting premiums paid for your US risks to

the captive (as an ordinary business expense, whereas if self-insured there is no deduction until a claim is paid); the captive potentially achieving insurance company tax treatment; and possibly forming as a so-called “831(b)” captive for premiums under \$1.2m (USD) in gross written premium. Again, drop us a line at www.KregerBeeghly.com to chat about your particular circumstances as each deal is different and this is obviously not legal advice – it is an article.

Mechanics of the operation: OK, you’ve got US-risks you want to explore whether a captive makes sense. Here is a list of what we would anticipate Canadian entities would want to do to review their US exposure for a captive:

1. From our experience, Canadian organizations will need to start by gathering their data. Pull premiums together for all operations (especially the US based risks) and have as much detail as you can in terms of premium by line of coverage, by country, retentions/deductibles, and limits. Putting this together for as many preceding years as possible would be helpful. Same for losses. Not just losses that resulted in a lawsuit. But all claims. As much detail as possible as to defense costs, indemnity for as many years as possible. If you imagine you are starting to think like an underwriter as to whether you would want to underwrite your own risks and for how much – that is a good state of mind;
2. Review the data with your trusted service providers. Does it appear [prior to speaking with an actuary] that the premiums are greater than the losses? Has this historically been the case? Is it enough to ‘make it worth the exercise’? If so, proceed to step 3;
3. Work with your service providers to find and engage an actuary to help you with a feasibility study. This study will tell you how your risks look compared to the industry. It will also tell you if it looks like from prior experience you would be profitable in retaining your own risk, and if so, what you would need to charge to do this. This study is needed not just for your internal analysis, but also for your other stakeholders such as fronting companies (for policy issuance), regulators (for where you domicile the captive), and reinsurers. Call us and we can discuss with you further;
4. Work with service providers that understand US risks into a captive to design the program, domicile comparison and selection, and RFP process for the different services you may need;
5. Engage captive manager and other service providers (once domicile is selected) and apply for a captive license, secure fronting and reinsurance;
6. Meet with regulators and service providers;
7. Apply for captive license, (assuming) secure license, capitalization and all other necessary conditions for operation complete, and begin underwriting;
8. Ideally then meet all of your goals for forming the captive and operate same for many, many years to profitability.

Obviously this is simplified. Canadian entities that previously had experience with Barbados but now also have Bermuda and Cayman competing for their business is a topic beyond this brief article. Do please give us a call to chat about that and about other technical nuances of US domiciles and individual state characteristics to see if it makes sense to capture your American insurance costs as profits. Obviously this article is just that – an article giving an overview and not legal advice and no attorney-

client relationship is ever created by reading one of our marketing articles. Good luck!
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