An Introduction to:

Alternative Risk Solutions

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About Energy Insurance Services

Energy Insurance Services, Inc. (EIS) was originally incorporated in Bermuda on May 27, 1992 under the Companies Act of 1981 as Energy Insurance (Bermuda) Ltd. Upon completing redomestication requirements and moving onshore to South Carolina, EIB was renamed EIS on December 1, 2006.

The company was established to provide risk management alternatives for EIM Members. EIS is authorized to write insurance or reinsurance for a Member or group of Members through the use of protected cells called Mutual Business Programs (MBPs). Policies may be issued through the Member's MBP for contracts of insurance, reinsurance and coinsurance.

EIS is licensed to conduct insurance operations in South Carolina. Members are responsible for determining and paying any taxes or levies due under local laws.

EIS is a wholly-owned stock insurance subsidiary of Energy Insurance Mutual Limited (EIM) providing a risk management vehicle to EIM Members.

Energy Insurance Services is a sponsored cell captive insurance company only available for consideration by existing EIM Members.

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About EIS

As a Mutual Business Program ("MBP" participant in EIS, each MBPs assets and liabilities are kept segregated and are separately identifiable from the assets and liabilities of other MBPs.

EIS manages the accounting, administrative and compliance functions for each MBP. Services include interfacing with the South Carolina Department of Insurance on regulatory issues, coordinating legal, actuarial and brokerage services, providing certain underwriting and claim payment functions, banking and investment oversight, and audit coordination as well as monthly and quarterly financial reporting for each MBP.

Initial cost of beginning operations for an MBP generally consists of the cost of performing a risk analysis, administrative fee payable to EIS and the cost to capitalize the new MBP. Each MBP must provide sufficient surplus to meet specific requirements of its Program. The surplus can be in cash or a letter of credit, but is subject to approval by the South Carolina Department of Insurance.

Each MBP is governed by a Program Advisory Committee (PAC consisting of representatives of the insureds. The PAC meets regularly throughout the year to advise EIS on various underwriting, claims and investment recommendations. Annually, EIS holds a conference in South Carolina for all PACs to attend. At the conference, the PAC members are updated on current regulatory information, the latest captive developments and have individual annual business meetings with EIS's senior management, insurance managers and their advisors and consultants to discuss current and future operational issues important to their MBP.

South Carolina as a Domicile

As a sponsored captive insurance company, EIS is subject to the captive laws of the state of South Carolina. South Carolina is currently one of the top onshore captive insurance company domiciles in the United States. The Department of Insurance is headquartered in Columbia, South Carolina.

Written Coverages

EIS is authorized to write insurance and reinsurance for a wide array of coverages, subject to the South Carolina captive insurance statute or regulatory guidelines. Policies may be either risk bearing or reinsured. Below is a representative sample of current lines of insurance EIS writes on behalf of our Mutual Business Program Participants. EIS is not limited to these lines of insurance.

Third Party Liability

- General Liability
- Auto Liability
- Marine Liability
- Protection & Indemnity
- Excess Liability
- Employers Liability
- Professional (Error & Omission) Liability
- Directors' & Officers' Liability
- Pollution Legal / Environmental Liability
- Wildfire Liability – Property Damage Only
- Non-traditional indemnity

Workers' Compensation

- Workers' Compensation – Deductible Reimbursement
- Excess Workers' Compensation

Benefits

- Trust Owned Health Insurance – L-T Retiree Medical Stop Loss

- **First Party Insurance**

- Commercial Property
- Nuclear Property
- Auto Physical Damage
- Unmanned (Drone) Aircraft Physical Damage
- Crime / Employee Dishonesty
- Railroad Rolling Stock
- Builders / Construction Risk
- Inland Marine including Contractors Equipment
- Marine Hull and Machinery
- Medical Stop Loss (traditional specific and aggregate)

Other

- Terrorism Wrap
- Cyber Risk
- Railroad Protective Liability
- Contractors Protective Liability

Considering a Captive Program

What Is A Captive?

A captive is an insurance company whose primary purpose is to finance risk for insureds with common insurance interests and needs.

What Types Of Captives Are There?

Here are a few examples:

- Pure captive is a wholly owned subsidiary established primarily to insure the risk of its parent company.
- Associate captive (risk pool) has two or more parent companies with similar risk exposures.
- Group captive is jointly owned by a number of companies, created to provide a vehicle to meet a common insurance need.
- Sponsored captive allows a contractual relationship between the captive and its 'participants' via a participation agreement and segregates the assets and liabilities of any individual participant through separate 'protected cells'.
  [Energy Insurance Services is a sponsored captive]

When Should The Risk Manager Consider Setting Up A Captive?

A captive is an insurance company. It is important to make sound decisions on what risk to assume as well as to determine if the risk exposure being considered can be controlled. Risks that cannot be controlled or managed may be better handled by transferring them to a commercial carrier, or isolating that risk in a separate cell (MBP).

What Are The Biggest Advantages Of A Captive Arrangement?

The captive arrangement has many advantages. Premium dollars are spent to manage the risk and not spent to add a profit margin to a commercial insurance company. Additionally, captive participation may provide a competitive return on investment over time. If the claim experiences are as expected, the captive will be capable of meeting its financial obligations, assuming more risk, or returning excess surplus to the insureds.

What Are Some Disadvantages Of A Captive Arrangement?

Managing a captive requires the assumption of risk. The decision to form a captive must be a long-term commitment. Starting a captive calls for access to capital to establish the captive that must be available for immediate claim liabilities. It does not make sense financially to set up a captive with the idea of reverting to a commercial policy when the market turns around.

What Are The Benefits of a Sponsored (Protected Cell) Captive?

Managing a small captive insurance company requires technical expertise and dedicated resources, which can be difficult to retain outside the industry. An existing sponsored (protected cell) captive insurance company can provide the experience to ensure compliance with regulatory, federal and accounting requirements as well as provide guidance on claims and underwriting issues while managing the various legal and financial service providers.

Why Form A Captive?

Many insurance and financial benefits can be realized through the use of a captive insurance program.

Risk Management - a captive can act as a focus for risk management and risk financing activities of its sponsoring organization. Being financially responsible for paying losses under captive or self-insurance programs can provide a greater incentive to prevent losses than under guaranteed cost insurance.

Coverage - captives have more flexibility in tailoring coverage to the needs of their insureds and providing coverage that is unavailable or prohibitively expense in the commercial market.

Lower Insurance Costs - this is achieved through no profit loading, elimination or reduction of other commercial expenses and lower administrative costs.

Insulation from market swings - captives have the advantage of being able to charge consistent premiums and build surplus to insulate its insureds from market swings associated with commercial insurance.

Cash Flow - premiums are typically paid in advance while claims are paid out over a longer period of time. By utilizing a captive, premiums and investment income are retained for the benefit of the insured. The captive can also provide more flexible premium payment plan thereby offering a direct cash flow advantage to the insureds.

Risk Retention - a company can manage its own risk by increasing the deductible levels. These deductibles can be insured through the captive providing an organized approach to managing and funding aggregate deductibles.

Access to risk transfer capacity (reinsurance) - as a licensed insurer, a captive has the advantage of being able to access the reinsurance markets. This can increase the potential sources of risk transfer capacity and reduce the cost. Direct access to reinsurance can reduce the frictional costs and lower federal excise taxes paid on the transaction.

Control over claims handling – captives have the potential to unbundle claims handling services with the insureds having control over the TPA contracts. The extent to which this can be achieved will depend to a large degree on the fronting and excess insurance or reinsurance arrangements supporting the program.

Tax Advantages - captives have a potential tax advantage over self-insurance in its ability to deduct premiums paid to the captive on a current basis. The tax treatment of captive premiums is an uncertain and fluid area. Captive sponsors should seek advice from an insurance tax expert on the appropriate structuring of captive arrangements and the matter of tax deductibility.

Getting Started

Obtain an Independent Feasibility Study

For companies that are assessing the captive option for the first time, a rigorous quantitative and qualitative approach helps determine whether a captive is appropriate for the organization's financial and strategic needs.

A feasibility assessment will determine candidate coverages for the captive in the short and longer term; define the operational parameters for the captive — whether it should be fronted or direct, where it should be domiciled, and its retention levels; and project potential financial results for the captive, including sensitivity analyses, to determine the economic viability of the captive.

A feasibility study will include the following steps:

- Collect and review relevant background information.
- Hold a strategy session with management to review information, confirm objectives/goals and discuss probable financial implications of captive formation.
- Develop claim projections.
- Estimate operational expenses associated with the captive and determine the captive premium.
- Advise on appropriate capital levels or margin for risk to support the written exposure.
- Describe qualitative factors that need to be considered relative to the formation of a captive, including domicile, structure and governance, management and support.
- Prepare pro forma financial statements presenting the balance sheets and income statements for a captive over a multiyear period on an "expected case" basis and under alternative scenarios.

The feasibility study will:

- Form the basis for management review and decision making.
- Provide concrete underwriting information that will be utilized when a captive of cell is formed.
- Provide a benchmark, or metrics, for future measurement of success.
- Formalize the body of information required for regulatory review and formation activities.

Notes

EIS Cell Proposal

Any EIM Member or group of Members wanting to form an MBP must submit a business plan for their Program to EIS. Using the feasibility study discussed in the previous section, the EIS submission should include the following items:

- Description of the Coverage(s) to be provided
- Explanation of Reinsurance to be purchased, if any
- Three year Business Plan
- Financial Statement of the submitting Member(s)

EIS will review the proposal and advise the submitting Member(s) throughout the approval process.

Upon approval of the Board of Directors, EIS will submit the proposal to the South Carolina Department of Insurance (SCDOI) for their review. For new programs wishing to issue an existing coverage within EIS, SCDOI prior approval is not required. However, if the coverage has not been previously written by another Program, the SCDOI will review the coverage terms and issue an approval opinion.

Once the approval process has been completed, the Member(s) Program will be established upon EIS's receipt of the following items:

- Executed Power of Attorney
- Executed Participation Agreement
- Notification of the Program Advisory Committee Members
- Capitalization Funding

Program Advisory Committee

Each MBP is required to establish a Program Advisory Committee (PAC) from among the Member(s). This committee will provide advice and recommendations to the Board of Directors in regards to the operations of the respective MBP.

Each PAC is required to meet at least once a year to review the operations of the Program.

The PAC is responsible for making recommendations to EIS in all areas of Program operations, including but not limited to:

- Investment of Assets
- Policy Issuance
- Reinsurance
- Claim Reserves and Payments

Premium Determination

Premiums must be determined based on standard industry practices including using comparative pricing to commercially available policies with consistent terms and features.

EIS's Insurance Manager may assist the Program with policy rating, but in either case, support for the premium amount charged for each policy must be submitted to EIS prior to policy issuance.

The feasibility study discussed in the previous section should provide an actuarially determined premium for the initial policy period.

Policy Issuance

EIS's Insurance Manager may assist in the development of the policy form, or the initial form may be provided by the MBP.

EIS's Insurance Manager will review the policy to ensure that it complies with all requirements of the South Carolina insurance regulators and EIS, including mandatory endorsements.

The original policy will be executed by EIS's Insurance Manager, as authorized by the Participant's Power of Attorney, and forwarded to the PAC Chairman or designee. A copy of the policy will be maintained in EIS's underwriting file along with the support for the premium amount.

Mandatory Endorsements

Mandatory Endorsement B

Each policy written within EIS must include Mandatory Endorsement B.

This endorsement limits the amount all claims paid to the aggregate of the assets belonging to the Program.

Mandatory Endorsement M

Each policy written for multiple insured parties must either include Mandatory Endorsement M, or at the direction of the PAC, separate policies may be issued to each insured.

The Participant's internal accounting records supporting premium payments from each insured are to be maintained in MBP files accessible for review and confirmation by EIS.

Federal Excise Tax

EIS considers all reinsurance premiums paid to non U.S. firms as subject to Federal Excise Tax unless proof of one of the following conditions are met:

- The reinsurer has made an election to be treated as a U.S. company for tax purposes by making a 953(d) election.
- The reinsurer is in a jurisdiction that participates in a tax treaty with the U.S. and the reinsurer has a closing agreement with the IRS that waives Federal Excise Tax.
- The non U.S. reinsurer is subject to U.S. Federal Income Tax for their U.S. based operations and has a tax document that supports this limited application of Federal Excise Tax.

  Satisfactory proof of FET exemption, as identified above, or proof of FET payment including the amount and date of such payment must be maintained in EIS's Underwriting file.

Tax Deductibility of Premiums

The deductibility of premiums paid by participants in MBPs will vary depending upon the structure of the Program. It is the responsibility of Program participants to determine the deductibility of premiums to be paid to EIS.

Investments

Investment funds in use by EIS's various Programs must first be approved by the Board of Directors.

To add a new fund to the inventory of approved investment funds, the Program's PAC must send a written recommendation to EIS. After review, EIS management will submit the request to the Board of Directors for approval.

All approved funds are available for use by any Program. Upon written recommendation from the Program's PAC, and subsequent approval from EIS, EIS's Insurance Manager will be responsible for transferring the appropriate funds to the proper investment account(s).

Periodically, EIS's Insurance Manager will provide each PAC with a summary of the Program's current investments and returns.

Loss Reserves

Reserves must be established, by the PAC, based on standard industry practices and supported by periodic actuarial studies.

Under no circumstances with the amount of reserves exceed a given Program's total assets.

Claims Processing

The PAC will initiate the claims payment process and retain all supporting documentation in their claims files. Payment requests will be directed to the Program's TPA, if applicable, and/or EIS.

Management Fees

EIS will provide basic services to each MBP as agreed. This will generally include investment of assets, program auditing, policy rating, policy issuance and claims payment. EIS will charge an annual fee for basic services.

Non-recurring services, such as opinion of counsel concerning premium deductibility, will be the responsibility of the respective MBP. In addition, some recurring, program-specific expenses that may vary by MBP will be the responsibility of the specific MBP.

Membership in EIM offers unique advantages to companies considering alternative risk options. To learn more about EIS, contact:

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Notes

EIS conducts its business from its corporate offices in Mt. Pleasant, South Carolina. EIS is only licensed to conduct insurance business for and on behalf of our Member insureds in South Carolina. EIS is not licensed to conduct insurance business in any other jurisdiction, including any state of the United States. The information contained in this document is for information purposes only. Nothing in this document should be considered a solicitation or offer to purchase insurance.