NOTES FROM KING STREET

Quarterly Newsletter from Energy Insurance Services, Inc., Volume 3, Issue 1

April 9, 2020

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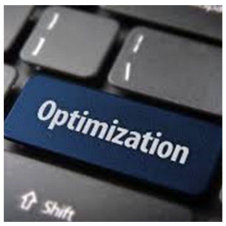

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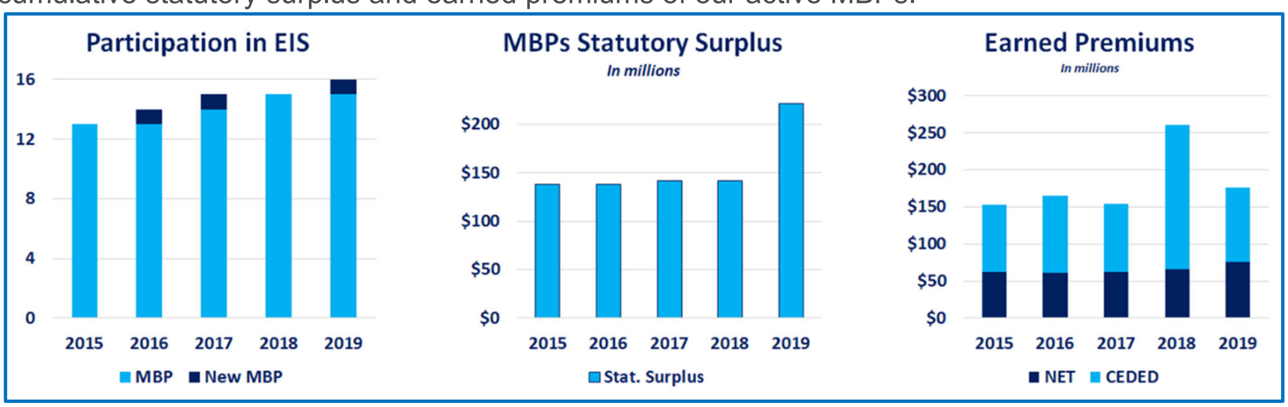
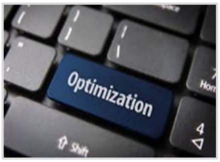
View from the Corner

As conveyed at the EIM Risk Managers Information Meeting in Orlando this past month, EIS and ECM enjoyed continued growth in 2019. The trends over the past 5 years are demonstrated in these three charts showing the number of open Mutual Business Programs (MBPs) or protected cells and the cumulative statutory surplus and earned premiums of our active MBPs.



This year, 2020, begins a new strategic planning cycle. The focus of our plan is entirely aligned with EIM. Although we have a very different operational model from EIM, the main-focus is the same – *Member Experience*. As a sponsored captive insurer, EIS is a facility exclusive to EIM Members where each Member/Participant contributes their own capital to provide a custom insurance program and/or to secure pass-through reinsurance via their MBP providing enhanced control and efficient risk financing.

Captive Optima



So far this year, EIS and ECM have been experiencing a very high volume of inquiries from EIM Members, directly or through their brokers about the EIS facility. This is not surprising, as the commercial insurance market is drastically reducing capacity and increasing pricing. Many EIM Members with healthy risk profiles are falling victim to categorization with peers that have, unfortunately, given the marketplace substantial losses. In other instances, their assets are deemed to be contributing to climate change and their long-term underwriters are abandoning them. The predictability of expected cost to transfer risk is gone. All of this is being further aggravated by the COVID-19 pandemic and the current volatility in global financial markets. Risk Managers are seeking how to regain control of their risk financing cost. Captive insurance is a very prominent means to regain control.

Because of this influx of inquiry, we hope to answer three questions that are being asked.

- **What is the cost to administer a program?**
- **How much capital is required?**
- **Is a feasibility study required and does an actuary need to be engaged?**

Our answer, typically starts with "it depends."

Cost to administer a program: We charge an annual management fee based on the level of captive management work, subject to a minimum. A great difference applies to our management fee than what our Members will find with other captive facilities and captive managers. Our fee is a fixed, flat annual amount that includes the following elements:

- all captive administration activities performed by ECM
- state premium tax
- financial auditing
- tax evaluation
- SOC 1 Type 2 audit and report
- state jurisdictional fees
- regulatory examination fees
- incidental legal and other incidental expenses

Capital: The minimum capital required to launch a new program in EIS is $250,000. Programs that pose significant risk to break-even or profitable underwriting may require additional capitalization. Determination of a proper level of capitalization may be obtained from a feasibility study with either an actuary's opinion or substantive financial modeling of historic losses. Capital may be provided in cash or with a letter of credit. EIS prefers cash if the program is largely risk bearing with no or minimal reinsurance.

Feasibility study/Business plan: We will typically recommend a feasibility study be conducted when significant risk is to be underwritten and retained in a new program. Depending on the nature of the risk, we may suggest the engagement of an actuary to review the loss history of the lines of business being considered. With or without an actuary's analysis being part of a feasibility study, the study helps the prospective Participant and EIS define the expected outcomes of insuring risk in a captive facility. However, for new programs taking on less complex risk, we still look for a business plan that articulates the nature of risk, coverage forms, rating methodology and a statistical review of losses, at a minimum. Either a feasibility study or business plan will be the core of our statutory filing when seeking approval to add a new MBP within EIS.

Actuarial support: Programs with significant tail exposure requiring appropriate accounting recognition for incurred-but-not-reported (IBNR) reserves will likely require actuarial reviews to support these reserves.

Timeline of a new program: Another question asked of us pertains to how much time it takes to launch a program with EIS. The answer is based on the level of complexity of the risk(s) that are being sought to be covered and the means to do so. Below is a very generic timeline that can be considered a guide. Please note, several of our Participants have put programs together inside a month. This sample includes a feasibility study.

ACTION STEPS		Week1 - 6	Week7	Week8	Week9	Week10	Week11	Week12
1. Program Feasibility								
Determine if EIS is feasible and cost-effective	New Participant							
Review Participation Agreement	New Participant							
	EIS							
Request EIS proceed with formation/submit to EIS Board	New Participant							
Submit to EIS Board for Approval	EIS							
Determine capital structure and business plan scenarios	New Participant							
including capital and retention levels, premium volumes,	EIS							
Review financial reports/informal discussion with regulator	ECM							
2. Complete MBP SCDOI Submission	EIS							
	ECM							
3. Review Application and Business Plan with SCDOI	EIS							
	ECM							
4. Regulator Review and Approval	SCDOI							
5. Captive Management Setup	New Participant							
Determine fronting, reinsurance, investing, banking,	EIS							
policy language, , financial reporting, etc.	ECM							
6. Capitalize and Commence Operations	New Participant							
Sign Participation Agreement, form PAC, capitalize, open	EIS/ECM							
accounts, as needed, engage reinsurers, issue policy	EIS							

If you have come to a point for a new strategic direction to take control of your risk financing, we encourage you to look closer at a captive solution.

Operational Considerations

ENERGY CAPTIVE MANAGEMENT

When a new captive program is being considered, ECM along with Johnson Lambert, our public auditor and tax consultant, will review the GAAP and statutory accounting aspects of the risk, coverage structure and the insured(s) covered by the proposed policy(ies). After that review, ECM will determine whether it should treat the new EIS program as insurance for federal tax purposes. The Participant's company, likewise, will need to review the captive's insurance and come to their own opinion regarding how they determine the IRS will view the transaction from their perspective as an insured. In other words, the captive's insurance policy may or may not be treated as insurance for tax purposes.

Tax considerations should not be the single priority to determine if risk financing via a captive facility is appropriate to meet your overall risk financing objectives. However, if the policy is treated as insurance for tax reporting, it should positively affect cost efficiency and increase the program's accumulation of surplus. The primary criteria applied in the determination of whether a policy is insurance for federal income tax include the following:

Insurance Risk	Risk Transfer	Risk Shifting / Distribution

Insurance risk refers to the nature of the coverage written. The captive policy should generally be reflective of traditional insurance, meaning that it will perform like a traditional insurance policy. A primary question will examine if the covered losses are fortuitous in nature.

Risk transfer refers to the question of whether risk has been moved from one entity to another. In a sponsored captive facility (such as EIS) risk transfer very likely will not be challenged depending on suitable contract terms.

Risk Sharing/Distribution occurs when the captive's policy(ies) insure(s) several entities that are all paying a determined amount of premium into the facility and risk is being spread or shared across that group of entities. The brother/sister concept that arose from the *Humana* decision helped to frame this concept for captives 30 years ago.

The International Risk Management Institute's publication, *Risk Finance*, discusses these tax considerations and issues in depth. If you do not have a subscription you can access a brief article on the subject at Captive.com with this link: https://www.captive.com/news/2017/01/04/tax-deduction-premiums-paid-to-captives?

EIS Financials

As we closed our 2019 year, we look back and compare to the previous year across several key financial and operating attributes. The General Account data we share here is the Shareholder Equity of EIM in EIS (specifically the general cell.) This is effectively EIS' retained earnings or surplus and represents the value we bring to our parent, EIM. This is the financial attribute driving our gain-sharing program and allowing EIS to provide credits against our Participants' annual management fees.

The balance of the data is the culmination of financial and operational data from all Mutual Business Programs. Net revenues (largely premiums paid and retained within the MBPs) continues to grow. Overall asset and liability positions have changed very little year over year. Gross premium which includes premium that flows into facultative reinsurance is down as a couple of programs have reduced significant reinsurance support.

Energy Insurance Services, Inc.	2019	2018
Key Financial Data as of December 31 ($millions)		
EIS General Account		
Shareholder Equity	**$4.2**	**$3.5**
Mutual Business Programs – Aggregated		
Net Revenues	**$73.9**	**$66.5**
Gross Loss and Loss Expense	**$54.7**	**$988.1**
Net Loss and Loss Expense	**$52.5**	**$61.5**
Assets	**$2,267.0**	**$2,283.2**
Liabilities	**$2,146.0**	**$2,141.0**
Surplus	**$221.0**	**$142.2**
Key Operational Data		
MBP Count	**16**	**15**
Policy Count – In Force	**65**	**63**
Gross Premium	**$174.2**	**$260.4**
EIM Member Participant Count	**19**	**19**

Save the Date!

2020 Program Advisory Committee
Meetings and Conference

October 26 – 29, 2020

Sterling Hall
Hyatt House / Hyatt Place
Historic Downtown Charleston, SC

Energy Insurance Services - An ***EIM*** Company

***Please note*: EIM & EIS will continue to monitor the COVID-19 pandemic and, if necessary, modify our plans accordingly, as we approach September.**

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EIS Mission Statement – "To provide a facility to meet EIM Members' dynamic and specific business requirements for the placement and management of alternative risk solutions."

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