

FINAL WORD



Nate Reznicek, director of operations at CIC Services, tells *Captive Review* about the consequences of the Reserve Mechanical case on risk pooling.

Nate Reznicek maintains an active leadership position in the captive industry and sits on the Captive Insurance Companies Association (CICA) Programming Committee as well as the International Center for Captive Insurance Education (ICCIE) Curriculum Committee and faculty member where he teaches the “Forming and Operating a Captive” course.

Captive Review (CR): How did the Reserve Mechanical case damage the reputation of risk pooling?

Nate Reznicek (NR): In Reserve Mechanical the tax payer was unable to provide sufficient evidence that the reinsurance premiums were adequately priced, (premiums received didn't equal risk received) so ultimately the deduction was disallowed. Decisions and opinions that are issued by US Tax Court are a result of the facts and circumstances unique to each case. Said another way, this case didn't tell us that risk pooling was bad it simply said that the pool that Reserve was participating in provided a deficient method of risk distribution.

Outside of a few minor players, I believe that the captive industry in general has a good grasp on the guidance we could glean from the Reserve decision. Outside of a few pools that had to restructure the method in which they attempt to achieve risk distribution the impact of the Reserve decision was largely isolated to the parties directly involved in the case.

CR: How important is risk pooling for the captive insurance world?

NR: Risk pooling is a critical component of insurance in general and is used by

organisations of all shapes and sizes. For small captives, participation in a risk pool is often the way that the captive obtains appropriate risk distribution. Should a captive be unable to achieve risk distribution through pooling or any other mechanism it would no longer be considered an insurance company for federal tax purposes. This would fundamentally change the economics of the transaction and impair the captive's ability to efficiently fund for future losses.

Risk pooling is commonly used by much larger captives as well. Most often seen with stop loss captives, larger organisations participate in risk pools and share expected claims costs with other pool members to help smooth their loss experience. A loss of pooling for larger captives would result in increased claims volatility, potentially jeopardising the solvency of the captive.

CR: How has the information surrounding risk pools adversely affected the industry so far?

NR: Fear, uncertainty and doubt (FUD) is being used as a sales crutch by desperate promoters that are trying as hard as they can to gain an audience in an industry that's passed them by. A disinformation strategy used in sales, marketing, public relations, politics, cults, and propaganda, FUD is generally a strategy to influence perception by disseminating negative or false information.

To an unsuspecting audience these faux warning cries seem alarming and often come from someone that would normally be considered credible, like a tax professional or an attorney. These promoters

often use large paid-for-publication services to give the appearance of credibility and spread their disinformation campaign as far and wide as possible.

I believe that the educated captive owners quite often own the most successful captives. People who take the time to evaluate and understand the pros and cons of a situation often make better decisions in a risk-based business. Disinformation campaigns and slimy marketing tactics can cause unnecessary confusion and turn qualified candidates away from a valid and legitimate tool for managing their risk.

We'll need to wait and see how the industry performs from a new formation standpoint at the end of the year – ultimately I don't think there will be much impact at all.

CR: How do you think CICA's guidance will benefit the industry?

NR: CICA remains one of the best sources of unbiased information, knowledge and leadership for the industry. Guidance issued by CICA is the work of a large number of highly-respected captive professionals and is never the work or voice of any one individual or corporation. I would strongly encourage captive insurance decision makers to view CICA as a trusted resource and to hold their captive advisors accountable to the best practices issued by the industry.

CICA's domicile-neutral approach and continued commitment to education and industry advancement goes a long way in the fight against the disinformation campaigns and noise created by desperate promoters. ☾