Highlight of Key Captive Pool Considerations

The Highlight of Key Captive Pool Considerations is intended to outline talking points to address various structural implications that the formation of a captive insurance subsidiary may have. These talking points do not express the tax opinion of Crowe LLP and are intended for discussion purposes only.

Captive Summary

- A captive insurance company is a legally licensed, limited purpose property and casualty insurance company.
- A captive's main business purpose is to insure the risks of the captive's owners or companies affiliated with the owners through ownership, management or control.
- A captive could provide coverage for deductible reimbursements, excess limits and uninsured or underinsured exposures.
- Each financial holding company could wholly own the captive subsidiary and control decisions of the entity.

Key Operational Benefits

- The captive provides uniform risk management and an enhanced view of organizational risk management.
    - The captive works in conjunction with the commercial program by insuring risks on a first dollar basis (e.g. deductibles, waiting periods, etc.).
    - The captive's coverages are structured to overlay the commercial insurance program. It is not intended for the captive to replace existing commercial insurance for unacceptable risks.
    - For the captive's initial year, the Company can modify its existing commercial insurance coverages prior to formation or choose to overlay the current existing commercial coverages and make commercial policy modifications at subsequent renewals.
    - Due to rising insurance rates, many businesses have migrated to higher deductible policies. In these instances, the captive can provide coverage for the higher deductible levels.

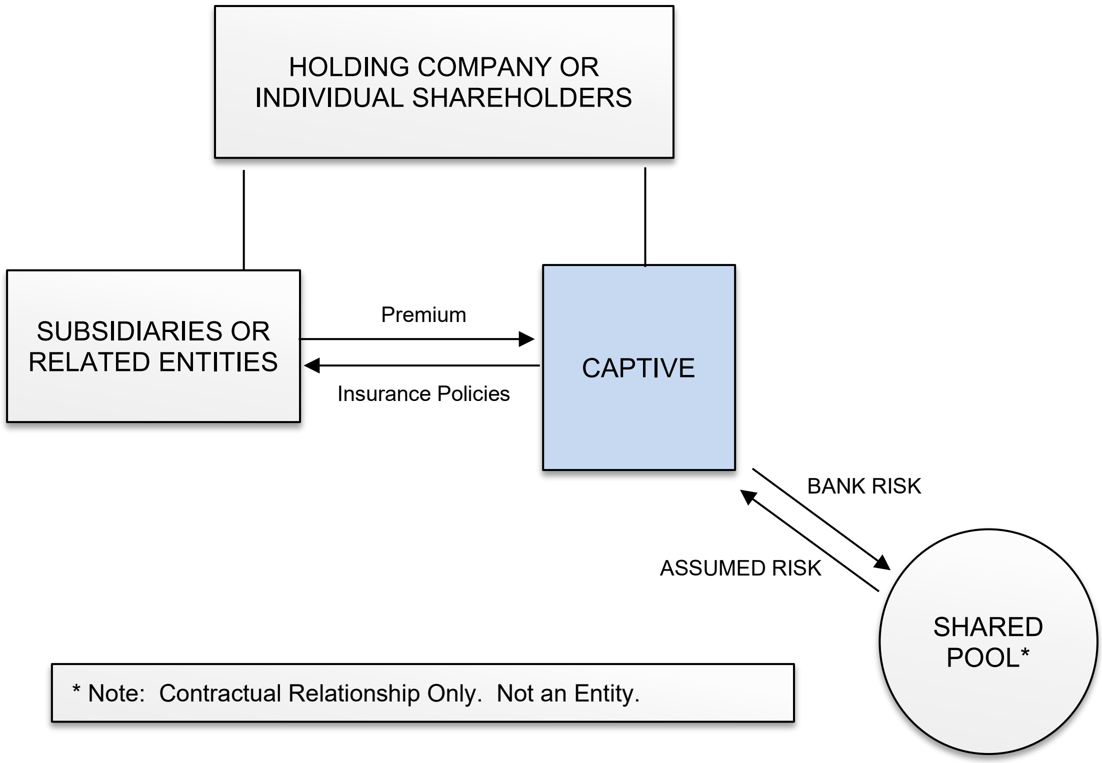
- Not all insurable business risks are addressed by commercially available insurance.
    - The captive can write insurance that commercial carriers will not.
    - The captive can write broader policy forms than commercial insurers.
    - The types of coverage offered by a captive insurance company are limited by the laws of the captive's domicile.

Potential Structure

- IRS Revenue Ruling 2002-89 guidance for risk shifting and risk distribution:
    - Greater than 50% of homogenous risk exposure is derived from unrelated third parties;
    - Parent company/primary shareholders also own 100% of captive;
    - Captive charges arms-length premiums, established by customary rating formulas;
    - No parental or related party guarantees made in favor of captive; and
    - No loans from captive to parent or insured subs.

- For 2022, when gross premiums paid to the captive do not exceed $2.45 Million, the captive can make an election under IRC §831(b) to be taxed solely on its investment income. Under IRC §831(b), the insurance company does not recognize premium income or receive a deduction for claims paid. The insurance company should carefully evaluate the impact of IRC §831(b) when considering the election. For tax years beginning after December 31, 2016, the annual premium limit was raised from $1.2 Million to $2.2 Million with inflation adjusters ($2.3 Million for 2018 and 2019; $2.35 Million for 2020; $2.4 Million for 2021; $2.45 Million for 2022) and a new diversification requirement was added.

- The diversification requirement is normally met in situations where the captive and the insured entities are owned by the financial holding company. There may be issues in unusual situations where related parties own other participants in the same risk pool.



<u>Organizational Structure – Potential to Reduce Bank Capital</u>

- Based upon the bank's structure and initial feasibility report results, the bank should allocate a portion of premiums to the holding company and subsidiaries related to management liability, general liability, crime, reputation, and property coverages according to the risks at each insured entity.

<u>Improving Risk Management by Implementing a Captive</u>

- With existing insurance coverage, companies transfer unacceptable levels of risk through commercial insurance. For unacceptable levels of risk, the implementation of a captive does not change the need for these services or affect coverages or relationships with your current providers. The captive enhances risk management by identifying and insuring existing risks, often hidden risks that are not covered by the commercial insurance package.
- As the captive program evolves, it is typical to make changes to the commercial and captive insurance programs. Potential modifications could include insuring larger commercial deductibles through the captive, providing primary coverage through the captive for risks previously insured commercially (when risks are deemed acceptable), etc.

Annual Operational Burden

- The captive's policies are written on an annual basis; therefore, there is an annual renewal in which the Company can reassess the program and augment the coverage limits, deductibles, and terms and conditions, if warranted. Any commercial insurance policy changes will be considered during the captive's annual renewal.
- The Company could choose to not fund the captive in any given year.

Potential Reporting Burden

- In November 2016, the IRS identified certain IRC §831(b) Transactions creating insurance structures as "transactions of interest" – possible tax avoidance vehicles the IRS considers to be potentially impermissible tax transactions. Although the IRS does not consider all IRC §831(b) transactions to be abusive, it is evaluating IRC §831(b) Transactions to determine those that are abusive. As part of this evaluation process, the IRS requires specific reporting for those small captives that insure related entities and that either have related party loans or similar transactions or that have loss ratios over a specified period less than 70% (which is very common). In addition, most captives electing IRC §831(b) have a reporting requirement as a transaction of interest.

Example of a Typical Captive Pool Program

Pooled Coverages - Excess $25,000 - $50,000 Retention*

- Property Coinsurance Reimbursement
- Property Difference in Conditions (DIC)
- Flood Deductible Reimbursement
- Flood Coverage (Excess and DIC)
- Earthquake Coverage (Excess and DIC
- Pollution Clean-Up, Inc. F/C Property (Excess and DIC)
- Ordinance or Law (Excess and DIC)
- Business Income (Excess and DIC)
- Restoration of Reputation Expense
- Pollution Liability (Inc. Foreclosed Property)
- Bond Deductible Reimbursement
- Workplace Violence
- Debit Card Fraud (Excess and DIC)
- ACH Transaction (Excess and DIC)
- Mortgage Protection
- Loss of Key Employee

Non-Pooled Coverages**

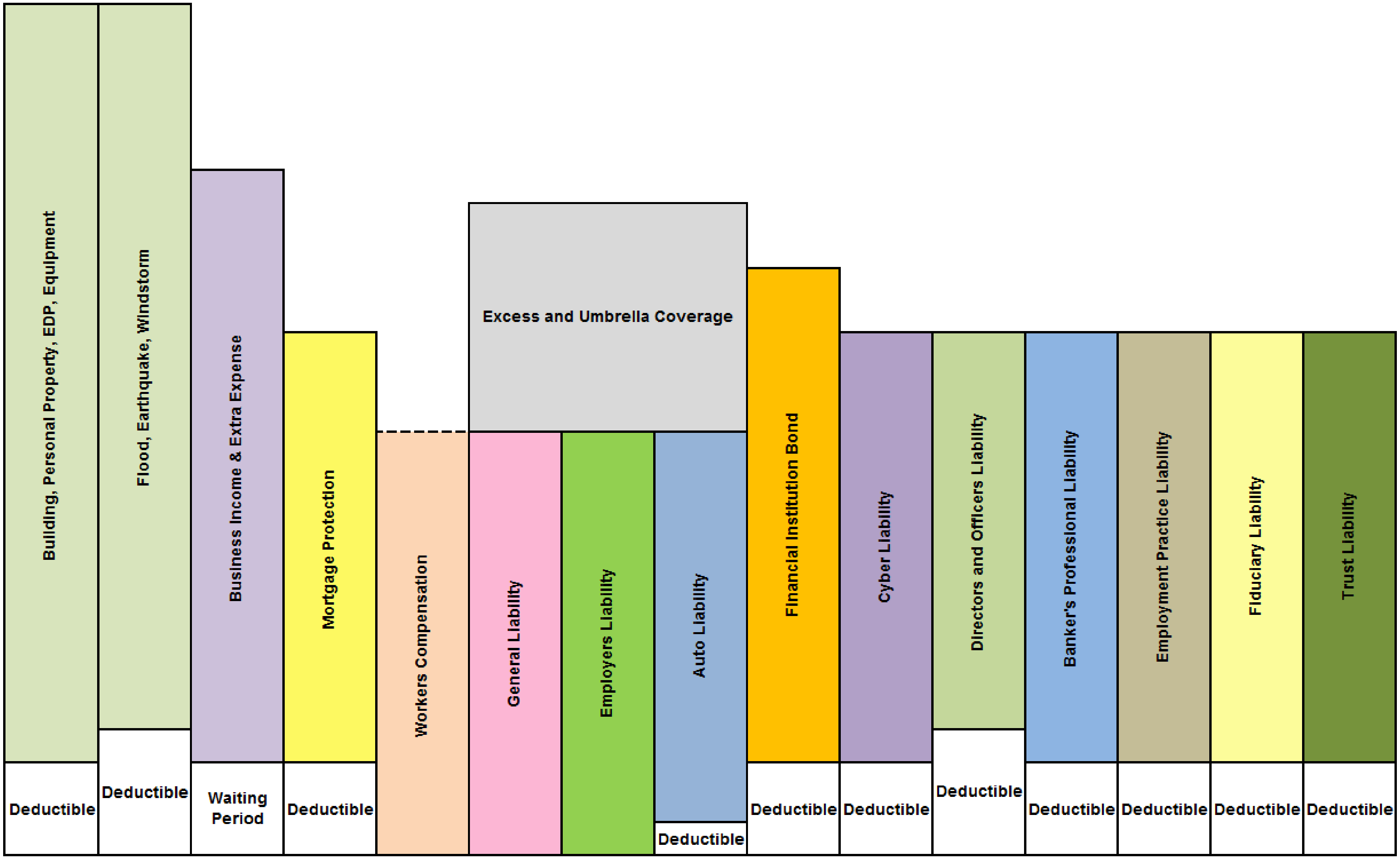
- Director and Officer Deductible Reimb.
- Employment Practices Deductible Reimb.
- Trust Liability/E&O Deductible Reimb.
- Banker Professional Liability Ded. Reimb.
- Insurance Agent E&O Deductible Reimb.
- Legal Expense Reimbursement
- Management Liability Excess
- Cyber Risk Deductible Reimbursement
- Cyber Risk (Excess and DIC)
- Crop Indemnification
- Accounts Receivable Fraud

* Pooled coverages are initially subject to a program aggregate ranging from $1.5 Million to $3.5 Million, depending on the captive program. Pooled coverages are also subject to a captive retention ranging from $25,000 to $50,000, depending on the captive program.

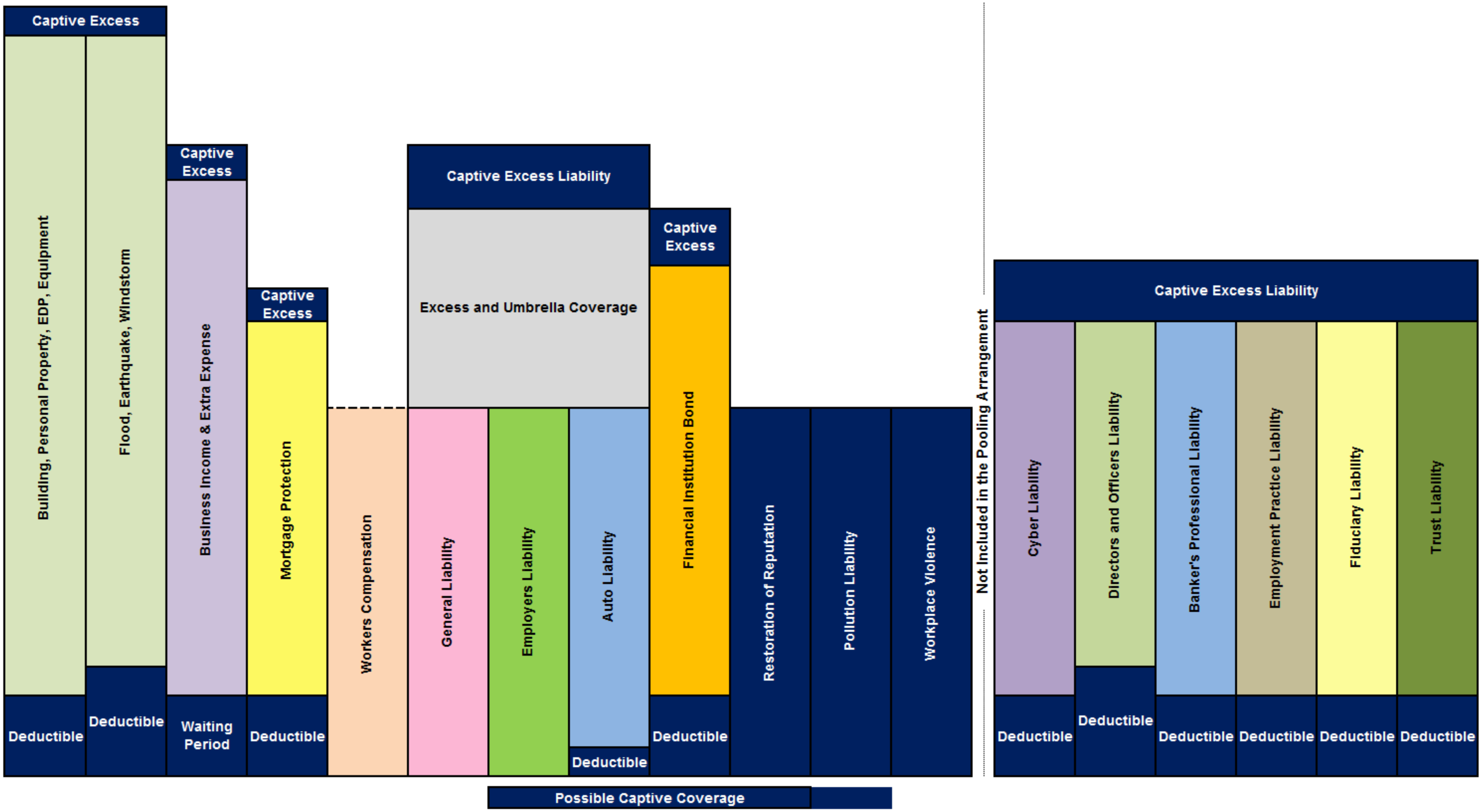
** Non-pooled coverages are initially subject to policy aggregates ranging from $1.0 Million to $2.0 Million, depending on the captive program.

See following pages for exhibits of a typical captive program.

CURRENT INSURANCE PROGRAM



POSSIBLE CAPTIVE INSURANCE PROGRAM



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