

2011 CAPTIVE ANNUAL REPORT FORM INSTRUCTIONS

A. GENERAL INSTRUCTIONS

This Arizona Captive Annual Report Form (CARF) is an Excel spreadsheet that is to be used by all pure, group, agency and reciprocal captive insurers in the preparation and filing of their annual reports required pursuant to ARS §20-1098.07 (unless otherwise instructed to use the NAIC Property and Casualty Blank by the Department). The CARF is due no later than 90 days from the end of the captive's fiscal year. The CARF must be accompanied by the following additional documents:

- Actuarial Opinion and Actuarial Opinion Summary – exemptions may be available
- Audited Financial Report (AFR) – due no later than six months after the captive's fiscal year-end (90 days after the filing date for the CARF), exemptions may be available
- Management Discussion and Analysis of Operations (MD&A)
- Certificate of Disclosure
- Copy of the parent's audited financial statement as soon as available

Refer to the Arizona Captive Insurance Division Reference Guide for exemption guidelines and the Appendices to the Reference Guide for instructions on the preparation of the Actuarial Opinion, Audited Financial Report and MD&A.

Basis of Accounting: The CARF is to be prepared based on generally accepted accounting principles (GAAP) unless the Director has required another basis of accounting such as statutory accounting principles (SAP). GAAP may be modified under certain circumstances by law. A common modification is the accounting for letters of credit provided for original capitalization, which may be treated as an admitted asset of the captive insurer. Modification to GAAP must be prescribed by law or approved by the Director. When modifications to GAAP have been included in the preparation of the CARF, the captive should explain those modifications in response to Question #18 in the Questionnaire of the CARF.

Filings: An original plus one copy of the CARF as well as the additional documents must be filed along with an electronic copy of the completed Excel spreadsheet. Do not file a PDF or other electronically imaged form of the spreadsheet. CARF and AFR filings which are incomplete or are not made within the prescribed timeframe will be subject to monetary penalties.

Signatures: The CARF must be verified under oath by affixing original wet signatures on the Jurat Page by two executive officers and the captive manager. The signatures must be notarized.

Entering Data: The CARF spreadsheet includes a macro that should be executed first prior to starting to enter financial data. The macro is titled "Data Entry" and is executed by clicking on the button shown on the Cover page of the CARF. This macro will prompt the user to enter the name, Arizona identification number and fiscal year end date for the captive insurer. This information will set up the proper dates for current and prior year headings information throughout the spreadsheet. Financial data entry may begin from any location subsequent to completing this procedure.

Printing the CARF: For your convenience, a print macro has also been included with the spreadsheet. It can be executed by clicking on the button located on the Cover page. Clicking this

button will print the entire CARF in one action. Alternatively, the user may print the CARF manually using the normal Excel print function.

Spreadsheet Protection: The spreadsheet has been password protected to prevent unauthorized modifications. It is important not to modify the spreadsheet form or content as this information is being electronically extracted by the Department for data and statistical analysis of captive insurers. If you encounter problems in entering data on the spreadsheet, please contact us for assistance.

Parent Financial Statements: The captive insurer should provide annually a copy of its parent's audited financial statement as soon as it is available.

B. ACTUARIAL OPINION and ACTUARIAL OPINION SUMMARY

An actuarial opinion on the adequacy of the captive's loss and loss expense reserves is an essential and required component of this annual review and must be rendered by a Fellow of the Casualty Actuarial Society, a member in good standing of the American Academy of Actuaries or an individual who has, in advance, demonstrated a level of competence satisfactory to the Director. An Actuarial Opinion Summary must accompany the Actuarial Opinion.

Refer to the Arizona Captive Insurance Division Reference Guide for exemption guidelines and the Appendices to the Reference Guide for instructions on the preparation of the Actuarial Opinion.

In her discretion the Director may request an actuarial opinion if the Department's analysis of the annual report determines that the captive's financial condition subjects its policyholders, claimants and other creditors to unusual financial risk.

C. AUDITED FINANCIAL REPORT

An independent certified public accountant must perform an annual audit of the captive's financial statement. The audited financial report is due within six months after the captive's fiscal year-end. Employees of the captive's parent or affiliates are not considered "Independent" when determining the qualifications of the certified public accountant that is opining on the captive's financial statements. The independent accountant must also provide a Letter of Qualification that shall be filed with the audited financial report.

Refer to the Arizona Captive Insurance Division Reference Guide for exemption guidelines and for instructions regarding changes in independent certified public accountant and the Appendices to the Reference Guide regarding the preparation of the Audited Financial Report.

D. MANAGEMENT DISCUSSION AND ANALYSIS OF OPERATIONS

The Department requires Arizona Captive Insurance Companies to file an MD&A with their Annual Report each year.

Refer to the Appendices to the Arizona Captive Insurance Division Reference Guide for instructions on the preparation of the MD&A.

The MD&A should include a discussion regarding all material changes and affiliate transactions.

E. GENERAL FINANCIAL STATEMENT INSTRUCTIONS

Page 1 - JURAT PAGE

The Jurat Page must be:

- 1) completed in its entirety;
- 2) submitted with original (not copied) signatures by two executive officers and the captive manager; and
- 3) Certified by a notary public with original stamp.

Officers and directors that have been newly elected during the year must have a “#” sign next to their name. A biographical affidavit (Captive 101A) and/or independent background check report must also be submitted for each of these individuals. The bio form or background report should be submitted when the individual is appointed, but no later than the submission date of the CARF.

The designated *Annual Report Contact Person* should be the individual that actually prepared the CARF.

Page 2 - ASSETS PAGE

Assets reported on Page 2 must be valued in accordance with GAAP unless otherwise instructed by the Department. Appropriate valuation reserves should be established for any amounts where collection may be doubtful. Space has been provided to write-in miscellaneous assets for *Other Invested Assets* and *Other Assets*. If space is insufficient for the captive’s miscellaneous assets, you should contact the Department for assistance.

Cash and Invested Assets: Invested assets should be valued and reported in accordance with GAAP. Do not include loans and other advances to affiliates on these lines. Pure captives filing on this form are generally exempt from Arizona investment limitation statutes unless instructed by the Department. Group or Agency captives filing on this form must comply with the investment requirements of ARS Title 20, Chapter 2, Article 3. If you have any questions regarding these limitations, please contact the Department. Amounts reported for *Cash and Cash Equivalents, Investments in Fixed-Maturity and Equity Securities*, should reconcile with amounts reported on Schedule A.

Premium Receivables: This line item should include uncollected premium balances, bills receivable for premiums and any amounts due from agents or brokers.

Reinsurance Recoverable: Reinsurance recoverable should include amounts recoverable from ceded reinsurance on paid loss and loss adjustment expenses. In accordance with GAAP, also include unearned premiums and amounts recoverable from reinsurers on unpaid loss and loss adjustment expenses. This line item should reconcile with the total reinsurance recoverable reported on Schedule F – Part 2.

Funds Held by Ceding Reinsurers: The amount reported on this line represents funds due and withheld from the captive by its fronting insurers and should agree to the amounts reported on Schedule F – Part 1.

Investments in and Advances to Affiliates: Bonds, stocks, or other investments in the captive’s parent or affiliates must have received prior written approval from the Department and are reported as non-invested assets under this caption. Please disclose terms of Investments in and Advances to Affiliates and date of approval in the MD&A.

Prepaid Reinsurance Premiums: Include all premiums forwarded to reinsurers on policies that are not yet in effect or due. If amounts advanced to reinsurers are material assets, details of the advances should be discussed in the captive's MD&A submitted as an attachment to the CARF.

Letters of Credit: Include the value of any outstanding LOCs that have been issued as part of the stated capitalization of the captive and are held by the Department with the Director of Insurance as the beneficiary. Other LOCs are inadmissible as assets in the CARF. Please identify the issuing bank, value and terms of the LOC in the MD&A especially if the captive has multiple LOCs.

Other Assets: Include any other admissible assets that are not included under any other account in the balance sheet.

Discuss changes in account balances in the MD&A.

Page 3 - LIABILITIES, CAPITAL AND SURPLUS PAGE

Loss and Loss Adjustment Expense Reserves: Loss and LAE reserves are to be reported gross of ceded reinsurance. The current year outstanding loss reserves should agree with the sum of amounts reported on Schedule P – Part 1 – Unpaid Loss and Loss Adjustment Reserves, columns 1 and 3. The current year outstanding LAE reserves should agree with the sum of amounts reported on Schedule P – Part 1 – Unpaid Loss and Loss Adjustment Reserves, columns 6 and 8.

Unearned Premiums: Unearned premiums are reported net of amounts ceded under reinsurance agreements and should agree with the total reported for the current year on Schedule C - Premiums.

Reinsurance Payable: Include amounts currently payable to reinsurers.

Funds Held under Reinsurance Ceded: Include reinsurance premiums withheld by the captive as specified in the reinsurance contract or advances to the captive by the payment of losses before the captive makes an accounting.

Loans and Notes Payable: The captive should report all loans and notes outstanding at year end. Material balances for this line item should be disclosed in detail in the MD&A filed concurrent with the CARF. When discussing loans and notes payable, the captive should provide details on loan terms, maturity dates and any collateral provided to secure payment.

Amounts Due to Affiliates: The captive should report all amounts due to parent or affiliates, including amounts due to asset sales and amounts due under management service agreements. Discussion of amounts paid during the year and amounts due at the statement date should be included in the MD&A accompanying the CARF. Current agreements should be submitted to the Department.

Dividends Payable: Include on this line both unpaid policyholder and shareholder dividends declared by the board of directors and approved by the Department. Dividends of all type must be approved by the Department prior to being declared and recorded as liabilities in the captive's financial statements. Indicate date of approval in the MD&A.

Taxes Payable: Taxes payable should include estimated amounts due to the Federal Government at year-end that have not been paid plus any deferred tax liabilities.

Other Liabilities: Space has been provided for the captive to include all other liability items that are not included elsewhere. Please note that any material liabilities included as write-ins should be described in the MD&A.

Capital and Surplus: *Paid-in Capital* should include any issued common and preferred stock at par value. *Paid-in Surplus* is any other amount paid into the captive's capital that is in excess of the par value of stock. *Surplus Notes* are funds loaned to the captive and supported by a written document that is in compliance with ARS §20-725. Identify the terms of surplus notes in the MD&A. Surplus note principal and interest may be repaid only with the written approval of the Director. *Unassigned Surplus (Retained Earnings)* represents the cumulative earnings from operations and should agree with the reconciliation included on Page 4.

Discuss changes in account balances in the MD&A.

Page 4 - INCOME STATEMENT

Premiums Earned: The current year earned premium amount should reconcile to the amount reported on Schedule C - Premiums.

Net Loss and Loss Adjustment Expense Incurred: The Net Loss and Loss Adjustment Expense Incurred equals the amounts paid during the current year plus any changes in reserves. Net Loss and Loss Adjustment Expense Incurred should agree with the amounts reported on Schedule P - Part 2 - Loss and LAE Incurred, columns 7 and 15.

Remaining Revenue and Expense Items: These items should be self explanatory. When in doubt err on the side of disclosure.

Discuss changes in account balances in the MD&A.

Page 5 - CASH FLOW STATEMENT

The Cash Flow Statement should include all cash inflows and outflows that will reconcile prior-year cash and equivalents to current-year cash and equivalents.

Page 8 – SCHEDULE C - PREMIUMS

Schedule C – Premiums should disclose direct written premiums and all premiums ceded and assumed, by line, to achieve net earned premiums. Net earned premiums should agree with the amount reported on the Income Statement.

Pages 9 and 10 – SCHEDULE F – PART 1 REINSURANCE ASSUMED and PART 2 REINSURANCE CEDED

Schedule F Part 1 and Part 2 should disclose the breakdown of amounts ceded to and assumed from specific carriers, and any amounts securing reserves for unauthorized insurers (Not Admitted in Arizona). The totals for premiums ceded and assumed should reconcile to the Schedule C -

Premiums. The MD&A should discuss any assets used to secure the captives obligations under reinsurance agreements.

Page 11 – SCHEDULE P - PART 1 - UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

Schedule P – Part 1 should disclose the breakdown of ending reserves, net of reinsurance, by line of business.

Ending Unpaid Loss Reserves columns 1 plus 3 and Unpaid LAE Reserves columns 6 plus 8 should agree with the Loss and Loss Adjustment Expense reserves reported on the Balance Sheet.

Page 12 – SCHEDULE P - PART 2 – LOSS AND LOSS ADJUSTMENT EXPENSE INCURRED

Schedule P - Part 2 - Loss and LAE Incurred, columns 7 and 15 should agree with the amounts reported on the Income Statement.

Pages 13 through 18 – SCHEDULE P – LOSS DEVELOPMENT BY LINE OF BUSINESS

Net losses triangles are included for each line of business on pages 13 through 18. The historical data on these schedules is carried forward from year-to-year. Separate sections are to be filled out for cumulative paid, outstanding case reserves and IBNR. These sections are then accumulated automatically to calculate cumulative incurred losses for the current and prior years. One-year loss development of each loss year is calculated as the difference between total incurred losses for the current year less the cumulative incurred losses for that loss-year at the prior year-end.

Page 19 – SCHEDULE P – SUMMARY LOSS DEVELOPMENT - ALL LINES OF BUSINESS

This summary schedule for the aggregate of all lines of business is automatically built from links to the individual line development schedules on the previous pages. No input is required.

Pages 20 through 22 - QUESTIONNAIRE

Dropdown menus are provided to answer many questions in this section. Generally the questions have been designed such that the answers will be simply a “yes” or “no.” “No” answers may represent concerns that the Department will focus on during its review of the filing. The captive should review these matters carefully and address the response in the space provided. If no space is provided on the questionnaire, please address the negative responses on the MD&A.

Question #1: Provide the full name of the ultimate controlling parent company.

Question #2: A dropdown menu is provided to answer this question as to whether the captive is licensed as a pure, pure – reinsurance only, group, group – reinsurance only, protected cell, agency or reciprocal captive company.

Questions #3 through #9: The captive should provide the contact individual, firm name and address in response to each of these questions regarding the principal managers and entities involved in the operations of the captive. To the extent that any of these individuals have changed from the prior report, the reasons for the change should be thoroughly discussed in the MD&A. A change in any of these individuals/firms is considered a material change in the captive’s business plan and should have received prior approval from the Department. Executed contracts should be filed with the Department.

We are presuming that the captive management firm's office is the principal place of business and that the books and records are kept at the captive management firm's office. If this is not the case, please provide a discussion in the MD&A.

Question #10: Disclose if the captive insurer has a resident director and the identity of that director.

Question #11: Disclose if the captive insurer had a board meeting in the State of Arizona and the date of that meeting.

Question #12: In response to this question the captive should provide a complete listing of all classes of capital stock outstanding. If the captive was formed as a mutual or reciprocal insurer, this question should be left blank.

Question #13: This question asks if all transactions of the captive insurer before the close of business were truthfully and accurately entered on its books.

Question #14: Disclose the largest net amount of insured/reinsured risk on any single risk per occurrence and in aggregate.

Disclose if the aggregate risk on any single exposure has increased during the year and by what amount the risk increased. If so, please provide an explanation in the MD&A and the date(s) approved by the Department. It would also be helpful to attach to the MD&A copies of the notification to the Department and a copy of the Department's approval of the change in order to expedite review.

Question #15: This question asks the captive insurer to identify if it writes deductible reimbursement coverages and what those coverages are.

Question #16: Disclose the captive insurer's minimum surplus as defined in the Conditions Addendum to the Certificate of Authority. If no condition exists, minimum surplus is the statutory minimum.

Question #17: Disclose whether or not any changes were made during the filing year to the captive's charter, by-laws or organizational documents. Material changes are subject to Department approval. If changes have been made, please provide a description of the change(s) made in the captive's MD&A, including the date of the Department's approval in the disclosure.

Question #18: Please select the method of accounting utilized by the captive: 1) GAAP, 2) modified GAAP, or 3) SAP.

The Department requires the captive to confirm whether it has changed its accounting method in the current annual report from the prior year. If so, please explain in the space provided.

If modified GAAP is selected, please include in the space provided a brief description of the methods of accounting used that do not conform to GAAP.

Question #19: Disclose if reserves are discounted and the discount.

Question #20: Disclose if the captive has adopted a conflict of interest policy for its directors, officers, key employees and affiliates that may be providing services to the captive.

Question #21: Disclose whether there have been any changes to the captive's business plan and include a description of those changes in the MD&A. Changes to the business plan would include, but not be limited to:

- Changes in affiliated and/or unaffiliated management contracts
- Changes to claims contracts
- Changes to reinsurance contracts
- Changes to loan contracts
- Changes to rates or underwriting criteria
- Changes to risk limits and retentions
- Changes in lines written and assumed.

Question #22: Disclose if any assets of the captive or its outstanding capital stock have been pledged as collateral for any loans to the captive or its affiliates. If so, please explain in the space provided or in the MD&A.

Question #23: Disclose if the captive is writing coverage on a direct basis, or reinsuring business produced by another carrier, on individuals and/or business entities that are defined as "controlled unaffiliated business" as defined pursuant to ARS § 20-1098(11).

If the answer to this question is "NO" and the captive is writing or assuming controlled unaffiliated business, disclose the percentage of total net premiums earned that relate to the controlled unaffiliated business during the year.

Question #24: For those captive insurers writing workers' compensation directly or self-insured retention, disclose if the parent still qualifies as a self-insurer. It would also be helpful to attach to the MD&A copies of the qualified self-insurer status.

Question #25: For those captive insurers recording loans or advances to its parent or affiliate on its Balance Sheet, disclose if the parent has obtained approval from the Department. Discuss the terms of the loan or advance on the MD&A. It would also be helpful to attach to the MD&A a copy of the Department's approval.

Question #26: For group or agency captive insurers, disclose if the captive insurer is in compliance with investment statutes or if it has obtained approval of its investment practices.

Question #27: Disclose direct written premium for risks in the State of Arizona versus all other states by line of business.

Page 23 – CROSSCHECK GUIDE

The Crosscheck Guide is intended to help the preparer and the Department to identify potential errors in the preparation of the annual report. You may disregard rounding errors. Please ensure that a copy of the Crosscheck Guide is attached to the annual report when it is submitted to the Department.