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July 7, 2020

1933 Act/§2(a)(1)

1934 Act/§3(a)(10)

Submitted electronically

U.S. Securities and Exchange Commission  
Division of Corporation Finance  
Office of Chief Counsel  
Mail Stop 4561  
100 F Street, NE  
Washington, DC 20549

**Re: Oak Harbor Reinsurance Company**

Ladies and Gentlemen:

On behalf of Oak Harbor Reinsurance Company, a North Carolina protected cell captive insurance company (the “Company”), we request the concurrence of the Division of Corporation Finance that the operation of the Company’s program to provide reinsurance in the context of group captive programs, including by having Insurance Participants (as defined below) enter into a Protected Cell Program Agreement, as defined below, and the Protected Cell Program Agreement itself (as hereinafter described, the “Program”), does not involve the offer and sale of a “security” within the meaning of the Securities Act of 1933, as amended (the “Securities Act”) or the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and the Division’s assurance that it would not recommend to the Commission that any enforcement action be taken with respect to the participation of Insurance Participants in the Program without registration thereof under the Securities Act.

**I. Structure of the Program**

**A. The Company**

The Company is a North Carolina protected cell captive insurance company, formed and licensed under the North Carolina Captive Insurance Act, N.C. Gen. Stat. §58-10-335 et seq., as may be amended from time to time (the “NC Captive Act”). As a North Carolina-domiciled insurer, the Company is subject to the insurance laws and regulations of North Carolina. The Company is an indirect wholly-owned subsidiary of W. R. Berkley Corporation, a listed

insurance holding company which, through its affiliated insurance companies, is among the largest issuers of commercial lines insurance policies in the United States (“WRBC”).

## **B. Description of Business**

While the Company has not yet commenced business, it was formed by WRBC to reinsure certain lines of commercial insurance business written by one or more of the WRBC insurance companies (each, an “Insurer”). WRBC has developed the Program to provide certain qualifying insureds with the opportunity to reduce the ultimate cost of their insurance coverage by participating in the loss experience associated with the policies issued by an Insurer and reinsured by the Company (the “Policies” and each, individually, a “Policy”).<sup>1</sup>

An insurer can allow its policyholders to “participate” in related loss experience in one of two basic ways: (i) by including a retrospective premium adjustment feature directly in the terms of the underlying insurance policy or (ii) by allowing the policyholder to participate in such experience through a captive reinsurer, in which the policyholder maintains some participatory interest. As a practical matter, the model described in (i) is individual policyholder-specific, while the model described in (ii) can be either individual policyholder-specific or allow risk pooling among different policyholders.

The Program follows the second model by affording qualifying policyholders the opportunity to join with a group of other qualifying policyholders in a group captive reinsurance program maintained through a protected cell (each, a “Protected Cell”) specifically established by the Company. For each policy year, the Insurer will cede to the subject Protected Cell, and the Protected Cell will reinsure, a portion of the risk insured pursuant to the underlying insurance policies. In consideration for such reinsurance, the Insurer will pay the Protected Cell a reinsurance premium representing a portion of the premium collected on each underlying insurance policy, less a ceding commission. Depending on the pooled loss experience of the Protected Cell for a given policy year and other conditions which are further described below, the policyholders participating in the Protected Cell may be eligible to receive a distribution from the Protected Cell, which, in turn, would reduce the insurance costs of such policyholders.

The Program is substantially similar to the group captive reinsurance program currently offered by WRBC, utilizing segregated accounts (the functional equivalent of protected cells) of East Isles Reinsurance, Ltd. (“East Isles”), which was established by WRBC as a segregated accounts company under Bermuda law in 2009.<sup>2</sup> As such, East Isles is authorized to establish, and does establish, segregated accounts, through which it reinsures policies issued to

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<sup>1</sup> While the Company was established as a reinsurer and will reinsure policies issued by an Insurer, there may be instances where the Company, if permitted under applicable law, issues an insurance policy directly to a participating insured, in which case the Program would be effected without the involvement of an Insurer.

<sup>2</sup> The group captive reinsurance program facilitated through East Isles Reinsurance, Ltd. was the subject of a no-action letter in 2009. East Isles Reinsurance Ltd., April 1, 2009 (“East Isles”).

participating policyholders. Under the East Isles program, qualifying policyholders may join with other qualifying policyholders in group captive reinsurance programs maintained through such segregated accounts. The definition of “segregated account” pursuant to Section 1 of the Bermuda Segregated Accounts Companies Act 2000 is substantially similar to the definition of “Protected Cell” under North Carolina law.<sup>3</sup> Under the Program, the Company will provide U.S.-based policyholders with an “on shore” alternative to participate in a group captive reinsurance program. The Company’s Program will be managed in a similar manner as the East Isles program, save for differences that are the result of the Company being a North Carolina regulated entity as opposed to a Bermuda regulated entity.

## **C. Description of the Protected Cells**

### **1. Protected Cell Program Agreement**

Under the NC Captive Act, the Company can establish separate protected cells, the effect of which is to insulate the assets and liabilities identified with and attributable to a particular protected cell from the assets and liabilities attributable to the Company’s other protected cells and from its general account. Each protected cell is self-sufficient and only the assets identified with and attributed to a particular protected cell can be applied to the liabilities identified with and attributed to that protected cell.

A group of at least three policyholders (each, an “Insured Participant”) will be required for a Protected Cell to commence operations. To be eligible, each Insured Participant must purchase its own Policy from an Insurer. To participate in the Protected Cell for a particular policy year, each Insured Participant will be required to enter into its own separate Protected Cell Program Agreement (each such agreement, a “Protected Cell Program Agreement”) with the Company, setting forth (i) the Company’s obligation to manage and administer the Protected Cell, (ii) the Insured Participant’s pro rata share of the fees for the use, management and administration of the Protected Cell, and (iii) the specific terms and conditions upon which the Insured Participant will share in the Protected Cell’s financial results, including the amount of funding that the Insured Participant will be required to provide to the Protected Cell. An Insured Participant’s continued participation in the Protected Cell in succeeding policy years will require, for each such succeeding year, that the Insured Participant renew its Policy in such succeeding year, meet the Company’s financial review standards then in place, not be in breach of its prior Protected Cell Program Agreements, and enter into a new Protected Cell Program Agreement for such succeeding year.

An Insured Participant’s interest in the Program will not be certificated. Rather, the executed Protected Cell Program Agreement itself will represent and govern the participant’s interest in the Program. A copy of the form of the Protected Cell Program Agreement is attached

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<sup>3</sup> See NC Gen. Stat. § 58-10-80(7) & (8).

hereto as Exhibit A. While each Protected Cell Program Agreement will be substantially in the form attached hereto, the executed Protected Cell Program Agreement may vary depending on the line of business that is covered under the Program, the type and corporate structure of the Insured Participant and other Insured Participant-specific factors.

## **2. Funding and Fees**

The Protected Cell's funding will be derived primarily from two sources:

- First, a portion of the premiums paid by Insured Participants in connection with their Policies will be paid/ceded to the Protected Cell net of certain deductions. The amount of net premiums that are paid/ceded to the Protected Cell for a policy year will be determined by an Insurer or the Company, as applicable, based on estimates of the aggregate cost of settling the expected claims and related expenses arising under the Policies for that policy year.
- Second, Insured Participants will pay certain amounts to the Company in connection with the execution of, and pursuant to, the Protected Cell Program Agreement for any policy year ("Initial Funding"). The Initial Funding is a requirement of participating in the Program through the Protected Cell and is used to fund the Protected Cell's operations, including collateralizing the Protected Cell's obligations to such Insurer. The Protected Cell will use or draw upon the Initial Funding at any time if needed to satisfy its financial obligations with respect to the policy year for which it was provided. An Insured Participant's Initial Funding obligation for each policy year in which it participates in the Protected Cell will be determined and set by the Company based on the Company's estimate of the aggregate costs the Protected Cell will incur in settling the expected claims and related expenses arising under Policies for that policy year as well as on the amount of the net premiums that will be paid/ceded with respect to the Policies. Each policy year will require separate funding, the amount of which will be determined independently of any funding provided for any prior policy years. As a result, an Insured Participant's continued participation in the Protected Cell will require the Insured Participant to provide the Initial Funding for each policy year that it participates in the Protected Cell.

The Company will return to an Insured Participant any Initial Funding that the Insured Participant previously paid to the extent that the Company determines that such funding will not be required for the policy year for which it was provided. The Company's obligation to return such funding on behalf of the Protected Cell will be subordinate to its obligation to pay all liabilities, claims, expenses, taxes and other charges, and any other financial obligations relating to the Protected Cell for the policy year for which such funding was provided. The return of any Initial Funding will also be subject to the Company's determination that, after the return of such Initial Funding, the Company will continue to satisfy the solvency and any minimum capital and surplus requirements that may apply to the Protected Cell. The return of any funding will be

without interest, gain or profit and may require approval from the North Carolina Department of Insurance (the “Department”).<sup>4</sup>

An Insured Participant may also be required to provide additional amounts (“Contingent Funding,” and together with the Initial Funding, the “Funding”) from time to time in accordance with certain terms and circumstances described in the Protected Cell Program Agreement.

An Insured Participant assumes responsibility for Funding necessary to allow the Protected Cell to satisfy its obligations to pay losses, expenses and other necessary amounts. The termination of the Stop-Loss Policy or the termination of the policyholder’s status as an Insured Participant does not relieve a participant from the obligation to fund those amounts for the applicable policy year subsequent to any termination of such Insured Participant’s participation in the Program. In such a case, the terminated Insured Participant would be responsible for any unpaid funding previously due, as well as any subsequent Contingent Funding that may be necessary to satisfy the obligations of the reinsurance and other related obligations of the Protected Cell for that policy year.

The Company will have the sole discretion to invest the Protected Cell’s funds, including funds received as ceded premiums, Initial Funding, and Contingent Funding, in any manner it deems reasonable, subject to applicable law. The Company intends to invest funds in cash and cash equivalents, such as short-term money market accounts.

The Protected Cell’s financial resources for each policy year will be limited to the net premiums paid/ceded to it with respect to the Policy for that policy year; the investment income earned thereon, if any; the Initial Funding provided by the Insured Participants participating in the Protected Cell for that Policy year; and any additional Contingent Funding provided by such Insured Participants, if and when required. The net premiums together with the Initial Funding provided by the Insured Participants with respect to a policy year are intended to be sufficient to satisfy losses to be incurred by the Protected Cell under the Policy for that year.

The Company will be paid a management fee and an administrative fee in connection with the management and administration of the Company and the Protected Cell, each as identified in the Protected Cell Program Agreement. The management fee for each policy year will be calculated as a percentage of the final adjusted gross written premium paid by an Insured

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<sup>4</sup> Pursuant to Section 58-10-375 of the North Carolina Insurance Code, all dividends or other distributions from a captive insurance company require the prior approval of the Department. However, the statute also allows the Department to approve an ongoing plan for the payment of dividends or distributions, conditioned upon the retention at the time of payment of capital and surplus in excess of amounts specified by or determined in accordance with formulas approved by the Department. It is expected that, upon commencement of operations, the Company will discuss with the Department the acceptable parameters of a formulaic approach, consistent with Schedule 4 of the Protected Cell Program Agreement, that will allow the Company to make distributions on an ongoing basis without specific approval for each distribution, provided that all such distributions are consistent with the formulas reviewed and approved by the Department, as well as any additional guidance that the Department may issue.

Participant for the Policy for that policy year. The administrative fee for each policy year will be calculated as a percentage of the Protected Cell's assets with respect to that policy year, excluding any Funding provided by the Insured Participant, subject to an annual calendar year minimum for the Protected Cell of \$25,000. To the extent expenses identified with or attributable to the Protected Cell are paid out of the Company's general account, the Protected Cell will reimburse the Company for such expenses.

### **3. Sharing of Liabilities**

To the extent that the net premiums, investment income, and Initial Funding are insufficient to cover the Protected Cell's financial obligations for such policy year, the Insured Participants participating in the Protected Cell for that policy year will be required to provide, in accordance with their Protected Cell Program Agreements, any required Contingent Funding to the extent that the claims, expenses and investment losses exceed the Protected Cell's financial resources.

### **4. Protected Cell Distributions**

The Company's board of directors, in its absolute sole discretion, will determine in accordance with North Carolina law whether and when the Protected Cell has sufficient financial resources to declare and pay a distribution out of excess funds (*i.e.*, attributable to positive loss experience) with respect to a particular policy year. In making that determination, the Company will assess the Protected Cell's financial obligations for such policy year, and will make distributions only if it determines, among other things, that the Protected Cell will continue to comply with applicable solvency and minimum capital and surplus requirements across all policy years after returning any excess funds that are no longer required for the particular policy year for which they were provided. A distribution for a particular policy year will be calculated on the basis of the difference between the sum of (i) net premiums paid/ceded to the Protected Cell and (ii) investment income (if any), on the one hand, and the sum of (a) losses payable under the Policy for such policy year, (b) expenses and charges for such policy year, (c) any other charges or amounts the Company in its sole discretion deems necessary or appropriate to meet the current or future obligations relating to the Protected Cell, and (d) any previous distributions for such policy year, on the other hand.

The Company will not declare or pay a distribution if there are reasonable grounds for believing that, after paying such distribution, the Protected Cell would be unable to pay its liabilities as they come due or the realizable value of its assets would be less than the aggregate of its liabilities. The payment of a distribution may require prior approval by the Department.

To be eligible to receive a distribution, an Insured Participant must have participated in the Protected Cell for the applicable policy year, must continue to be a participant at the time the distribution is declared and paid, and must not be in breach of its Protected Cell Program Agreement with respect to any policy year. If a policyholder is no longer an Insured Participant

at the time the distribution for the prior policy year is declared and paid, such former Insured Participant would not receive a distribution for such policy year. An Insured Participant's share of any distribution will be determined on a "Pro Rata" basis, as defined in Article 1 of the Protected Cell Program Agreement, and is based on the share of the Insured Participant's total Funding for that policy year, including Initial Funding and any Contingent Funding, as compared to the total Funding received by the Protected Cell from Initial Funding and any Contingent Funding for that policy year. No Insured Participant will be entitled to receive amounts greater than such Insured Participant's Funding contributions.

## **5. Marketing**

The Company will not participate in the marketing of the Program. Rather, representatives of the Insurer will announce the availability of the Program to independent insurance brokers and captive insurance consultants, who represent eligible potential policyholders. These brokers and consultants typically arrange for groups of such potential policyholders to submit requests to the Company for participation in the Program. The Program will be offered only to eligible employer policyholders in connection with the sale or renewal of a Policy. An employer can purchase a Policy without participating in the Program. If an employer joins the Program and subsequently fails to renew its Policy, then it will be terminated from the Program and will no longer be an Insured Participant.

## **6. Other Rights and Obligations**

### **a) Restrictions on Transfer**

An Insured Participant generally will be unable to transfer, sell, hypothecate, pledge, assign, or otherwise encumber any rights or interests it may have under its Protected Cell Program Agreement or in the Protected Cell. In certain limited circumstances, however, such as where an Insured Participant is merged, consolidated or sells substantially all of its assets to another business, the Company may in its sole discretion consent to the transfer of such rights and interests to the successor of such Insured Participant, provided that the transfer complies with applicable law, all required Department consents or approvals are obtained, and the successor Insured Participant executes a Protected Cell Program Agreement and assumes all of its predecessor's obligations thereunder (including the obligation to purchase a Policy from an Insurer).

### **b) No Management or Voting Rights**

Each Insured Participant participating in the Protected Cell will be a party to a Protected Cell Program Agreement and will be entitled only to the rights set forth in its Protected Cell Program Agreement. The Insured Participants will not have any voting or similar rights in the Company or the Protected Cell, and will not have any authority with respect to the management or oversight of the Company or the Protected Cell, including the authority to select vendors, to

set the terms of any agreements entered on behalf of the Protected Cell, or to use or distribute any asset identified with or attributed or otherwise linked to the Protected Cell. All voting power in the Company will be held indirectly by WRBC, the ultimate owner of all of the Company's outstanding common stock.

## **c) Termination**

A Protected Cell may be terminated in accordance with the terms of the Protected Cell Program Agreement by the Company or by Insured Participants representing a majority of the annual premiums paid/ceded to the Protected Cell for the current policy year. If a Protected Cell is terminated, the Company, acting for and on behalf of the Protected Cell, will not reinsure any additional Policies, but will remain liable for its obligations under any Policy previously entered into with the Protected Cell.

An Insured Participant's participation in a Protected Cell may be terminated (i) by the Company or the Insured Participant without cause upon required notice, or (ii) by the Company, with cause (x) automatically and immediately if the Insured Participant is wound-up or dissolved or ceases to be a policyholder in connection with the Program, or (y) by the Company with required notice if the Insured Participant breaches its Protected Cell Program Agreement or the Policy or under certain other circumstances described in the Protected Cell Program Agreement. Additionally, the status of an Insured Participant with respect to the Protected Cell will be terminated automatically and immediately if the Insured Participant ceases to be an insured under a Policy issued by an Insurer and reinsured pursuant to the Program, because the purchase and maintenance of a Policy is a condition to participation in the Program. If an Insured Participant has its status terminated, the Company will cease assuming risk with respect to the Insured Participant and will return to the Insured Participant any funding the Insured Participant previously provided (subject to a right of offset), but only to the extent such funding has not been used and is not and will not be needed by the Company to pay losses, expenses or any other charges deemed necessary or appropriate by the Company in its sole discretion with respect to the Protected Cell for the years for which such funding was provided.

## **II. Legal Discussion**

We are of the opinion that, under the foregoing circumstances, the operation of the Program as described above, including an Insured Participant's contractual participation in the Program pursuant to the terms of the Protected Cell Program Agreement and the Protected Cell



Program Agreement itself, does not involve the offering of a “security” within the meaning of Section 2(a)(1)<sup>5</sup> of the Securities Act or Section 3(a)(10) of the Exchange Act.<sup>6</sup>

Neither the Protected Cell Program Agreement nor any other aspect of the Program bears a label sufficient by itself to qualify as a security within the definition of Section 2(a)(1) of the Securities Act or Section 3(a)(10) of the Exchange Act.<sup>7</sup> In analyzing whether a particular arrangement is a “security,” however, the courts follow the general principle that “form should be disregarded for substance and the emphasis should be on economic reality.”<sup>8</sup>

## A. The Program Is Not an Investment Contract

If a financial arrangement lacks the characteristics of a traditional security, a court may nonetheless find that it is a security if it determines that the arrangement has the characteristics of an investment contract. In *Securities and Exchange Commission v. W.J. Howey Co.* (“Howey”), the Supreme Court described the test for whether an interest in an enterprise should be characterized as an investment contract as follows: “The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of

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<sup>5</sup> The definition of “security” in Section 2(a)(1) of the Securities Act is as follows: any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

<sup>6</sup> The definition of “security” in Section 3(a)(10) of the Exchange Act is as follows: any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

<sup>7</sup> Prior no-action letters analyzing captive reinsurance programs have focused on whether such programs possess the significant characteristics typically associated with “stock”. See, e.g., HCC Risk Solutions Company, March 4, 2013 (“HCC”); East Isles. Because we do not believe any aspect of the Program raises any genuine questions as to whether participation in the Program constitutes “stock,” we are not requesting any such guidance from the Division.

<sup>8</sup> *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

others.”<sup>9</sup> In our opinion, the Program will not involve the offer of an investment contract because participation in the Program does not involve an investment of money in a common enterprise; Insured Participants will have no expectation of profits; and the arrangement does not rely solely on the efforts of others. Instead, the Program represents an insurance arrangement pursuant to which Insured Participants may seek to reduce their cost of insurance.

## 1. No Investment

In *Howey*, the Supreme Court described the definition of “investment” as: “a contract or scheme for ‘the placing of capital or laying out of money in a way intended to secure income or profit from its employment.’”<sup>10</sup> Insured Participants participating in the Program intend to obtain insurance coverage, rather than to secure income or profit, through their payments to an Insurer and/or the Company. To participate in the Program, an Insured Participant must purchase insurance from an Insurer, which, in turn, cedes the Insured Participant’s risk in whole or in part to the Company, acting for and on behalf of the Protected Cell. The Company or the Insurer, as applicable, will determine the amount of premiums due from each Insured Participant in connection with the Policy. Its calculation will rely on its underwriting function and will take into account actuarial projections and other historical and projected data.

Similarly, an Insured Participant’s Initial Funding obligation for each policy year will be based on premiums paid by the Insured Participants, whether directly paid to the Protected Cell or ceded to the Protected Cell through an Insurer, and will be determined by the Company based on a preliminary estimate of expected losses and related expenses of the Protected Cell. Any required Contingent Funding will be based on the difference between initial estimated losses and related expenses and any subsequent estimated losses and related expenses and on the amount by which such losses and expenses exceed the Protected Cell’s financial resources. The amount of premiums and Funding due from an Insured is determined by an Insurer and/or the Company based on a risk assessment, and are required under the Protected Cell Program Agreement to be paid in full as a condition of participating in the Program.

In a later case, *International Brotherhood of Teamsters v. Daniel*,<sup>11</sup> the Supreme Court concluded that the investment prong of the *Howey* test was not met in a noncontributory, compulsory pension plan. The Court focused on whether the participants in such plan “chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security.”<sup>12</sup> Here, the Insured Participants will not receive a “separable financial interest with the characteristics of a security.” Instead, the Insured Participants will purchase and

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<sup>9</sup> 328 U.S. 293, 301 (1946).

<sup>10</sup> *Id.* at 209.

<sup>11</sup> 439 U.S. 551 (1979).

<sup>12</sup> *Id.* at 559.

consume a Policy issued by an Insurer, a portion of which is reinsured by the Company via the Protected Cell. An Insured Participant cannot maintain a relationship with the Company or the Protected Cell without obtaining and maintaining such a policy. As discussed above, the Protected Cell Program Agreement provides for automatic termination should an Insured Participant cease to be an insured under a current Policy reinsured pursuant to the Program. Thus, participation in the Protected Cell is a component of a transaction to acquire insurance coverage and to limit its claims exposure, and participation in the Program is contingent on and inextricably tied to the purchase of the underlying insurance policy.

Subsequently, in *Securities and Exchange Commission v. Edwards*,<sup>13</sup> the Supreme Court held that a payphone sale-and-leaseback arrangement was an “investment contract” within the meaning of the federal securities laws. In *Edwards*, investors purchased payphones and leased them back to the promoter in exchange for a fixed monthly payment; the amount invested was determined by the investor, based on a promise to receive a fixed rate of return. By contrast, the amount paid by an Insured Participant cannot be varied at the discretion of the Insured Participant. Instead, the amount paid by an Insured Participant will be determined by the Company based on insurance risk, not on the desirability of an investment or the expectation of a fixed or variable return. Furthermore, Insured Participants in the Protected Cell will not have the opportunity to determine the amount ceded to the Protected Cell and will receive no promise of a return on investment, fixed or otherwise.

In short, Insured Participants are not paying premiums or Funding for the purpose of securing income, profit, or any type of fixed or variable return, but rather for the purpose of purchasing insurance coverage with the added benefit of potential reductions to their cost of coverage. Insured Participants have no discretion as to the amount of money they must provide in order to participate in the Program. The Division of Corporation Finance has previously agreed not to recommend enforcement action in several circumstances where premiums were set by an insurance carrier based on its assessment of risk, as is the case here.<sup>14</sup>

## **2. No Expectation of Profit**

In *United Housing Foundation, Inc. v. Forman* (“Forman”), the Supreme Court explained that “[b]y profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors’ funds . . . . In such cases, the investor is ‘attracted solely by the prospects of a return’ on his investment. . . . By contrast, when a purchaser is motivated by a desire to use or consume the item purchased . . . the securities laws do not apply.”<sup>15</sup> Subsequently, in *Edwards*, the Supreme Court further explained the meaning of the “expectation of profits” prong of the *Howey* test as

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<sup>13</sup> 540 U.S. 389, 394 (2004).

<sup>14</sup> *See, e.g.*, HCC; East Isles.

<sup>15</sup> 421 U.S. 837, 852-53 (1975).

follows: “when we held that ‘profits’ must ‘come solely from the efforts of others,’ we were speaking of the profits that investors seek on their investment, not the profits of the scheme in which they invest. We used ‘profits’ in the sense of income or return, to include, for example, dividends, other periodic payments, or the increased value of the investment.”<sup>16</sup>

*Forman* involved the sale of shares of the common stock of Co-Op City, a cooperative housing corporation organized to take advantage of a New York statutory financing arrangement pursuant to which developers got access to low interest mortgage loans and tax exemptions for building housing for low-income residents. The Supreme Court rejected the theory advanced by the Second Circuit below that purchasers had a *Howey* “expectation of profit” from certain sources, including “rental reductions resulting from . . . the income produced by commercial facilities established for the use of Co-op City tenants”.<sup>17</sup> Instead, the Supreme Court found that income from commercial facilities established not for profit but to make certain services available to residents is “too speculative and insubstantial to bring the entire transaction within the [Securities Act].”<sup>18</sup>

Here, as in *Forman*, the Insured Participants are motivated to participate in the Program by a desire to use or consume the item purchased, namely, insurance coverage. The Program enables them to obtain such insurance coverage at a lower rate by spreading a portion of the risk. To the extent that the actual aggregate losses of the Insured Participants involved in a Protected Cell and expenses of the Protected Cell for a particular policy year are lower than projected, the Insured Participants may recoup a portion of their insurance costs through the Protected Cell’s distributions, thus lowering their aggregate cost of insurance. Investment income earned by the Protected Cell and available for the Protected Cell to use to pay for losses under the Policies and the Protected Cell’s own operating expenses, or for distribution in the event it is not needed to cover such obligations, is analogous to the potential income produced by the commercial facilities established by the cooperative housing corporation and returned as a rebate to Co-Op City residents when the income collected from the use of these facilities exceeded the cost of their operation. It is both incidental to the primary purpose of the Program (which is to reduce the cost of insurance to Insured Participants) and too speculative and insubstantial relative to the primary purpose of the net premiums and Funding (which is to cover claims attributable to the Policies). The existence of such potential financial benefit (*i.e.*, reduced insurance cost) does not bring the entire Program within the federal securities laws. The Division of Corporation Finance has agreed not to recommend enforcement action in similar circumstances where the insured parties could receive a return of premium payments through policyholder distributions.<sup>19</sup>

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<sup>16</sup> *Edwards, supra* note 13, at 394.

<sup>17</sup> *Forman, supra* note 15, at 846.

<sup>18</sup> *Id.* at 839.

<sup>19</sup> *See, e.g.*, HCC; East Isles.

In short, Insured Participants have no expectation of profits from their participation in the Program. Any distributions from the Protected Cell would be based on the loss experience of the Insured Participants and would represent an adjustment to an Insured Participant's cost of insurance, akin to a retrospective premium adjustment, rather than a return on investment.

### 3. Solely From the Efforts of Others

The Supreme Court has described "solely from the efforts of others" as meaning "to be derived from the entrepreneurial or managerial efforts of others."<sup>20</sup> The Ninth Circuit has described the test as "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."<sup>21</sup> As discussed above, there are no anticipated "profits" associated with the Program, although the Protected Cell may make distributions from time to time of excess funds attributable to the positive loss experience of the Protected Cell. To the extent that the Protected Cell is able to make distributions to Insured Participants, it will not be due to the managerial or entrepreneurial efforts of the Company. Instead, such distributions will only be possible because the claims paid out under the Insured Participants' Policies are less than the sum of the insurance premiums and investment income.

As the Company typically invests in cash and cash equivalents and short-term money market accounts, which have historically produced low returns, the investment income is not expected to be significant, and the contribution of such investment income to the financial position of the Protected Cell is consistent with traditional reinsurance company operations. The Company anticipates that any income from investments will be minimal in comparison to a Protected Cell's losses, expenses and other amounts. Consequently, the Company does not expect investment income to have a material effect on any distributions to Insured Participants based on lower than anticipated loss experience or to be the primary source of any payments made under the reinsurance agreement.

Furthermore, the Company does not have any control over the amount of payments to be made under the Policies, which will be the most significant factor in determining the amount of distributions, if any. Consequently, the Company's efforts on behalf of the Insured Participants are neither "undeniably significant," nor do they have a significant effect on the failure or success of the enterprise. The Division of Corporation Finance has agreed not to recommend enforcement action in similar circumstances where a participant in a reinsurance pool is eligible to receive a partial rebate based on policyholder distributions.<sup>22</sup>

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<sup>20</sup> *Forman*, *supra* note 15, at 852.

<sup>21</sup> *Securities and Exchange Commission v. Glenn W Turner Enterprises Inc.*, 474 F. 2d 476, 482 (9th Cir. 1973).

<sup>22</sup> *See, e.g.*, HCC; East Isles.

Because participation in the Program does not involve an investment or any expectation of profits solely from the efforts of others, we are of the opinion that participation in the Program would not constitute an “investment contract” as that term has been construed by the courts.

**B. Conclusion**

Based upon the foregoing, we respectfully request that the Commission concur in our opinion that an Insured Participant’s contractual participation in the Program pursuant to the terms of the Protected Cell Program Agreement and the Protected Cell Program Agreement itself would not constitute the offer and sale of a “security” within the meaning of the Securities Act or the Exchange Act. We respectfully request the Staff to advise us that it will not recommend enforcement action to the Commission if the offer and sale of an Insured Participant’s participation in the Program were consummated as described herein.

\* \* \*

If you have any comments or questions relating to the request, please do not hesitate to contact the undersigned at 202-736-8615.

Sincerely yours,

/s/ Thomas J. Kim

cc: Robert J. Cerny, W. R. Berkley Corp.  
Michael P. Goldman, Sidley Austin LLP

**Exhibit A**  
Protected Cell Program Agreement

[See attached.]

**Exhibit A**

**Protected Cell Program No. \_\_\_-\_\_\_1 Agreement**

THIS AGREEMENT, effective \_\_\_\_\_, is made by and between Oak Harbor Reinsurance Company, a North Carolina protected cell captive insurance company (the “**Company**”), the Company in respect of Protected Cell Program No. \_\_\_-\_\_\_ (the “**Protected Cell**”), and \_\_\_\_\_ a(n)   (state)   [corporation], (the “**Insured Participant**”).

WITNESSETH:

WHEREAS, the Company is licensed by the North Carolina Department of Insurance and doing business as a protected cell captive insurance company pursuant to the North Carolina Captive Insurance Act, Chapter 58, Article 10, Part 9 of the North Carolina General Statutes (the “**NC Captive Act**”), for the purpose of creating and administering protected cells of the Company for the benefit of entities seeking participation in such cells; and

WHEREAS, under the NC Captive Act, protected cells of North Carolina captive insurance companies, including the Protected Cell, are separate and distinct accounts established by the company in which specific pools of assets, rights, liabilities and obligations of the company that are identified with and attributed to the particular accounts are segregated from the remainder of the company’s assets, rights, liabilities, and obligations in accordance with the terms of one or more participation contracts, in order to fund the liabilities and obligations of the protected cell; and

WHEREAS, the Insured Participant is desirous of participating in an insurance program (the “**Program**”) that requires the use of the Protected Cell; and

WHEREAS, in connection with the Program, each participant in the Program will purchase stop-loss coverage (each, a “**Stop-Loss Policy**” and, collectively, the “**Stop-Loss Policies**”) from an admitted United States-domiciled insurance carrier (the “**Insurer**”) to cover its financial risk from catastrophic claims that may arise from its stand-alone, self-funded employee welfare benefit health plan; and

WHEREAS, in connection with the Program, the Company, acting for and on behalf of the Protected Cell, and the Insurer will enter into a Reinsurance Agreement, defined below, pursuant to which the Insurer will cede to the Protected Cell a portion of the premiums it receives and the risks it assumes under the applicable Stop-Loss Policies; and

WHEREAS, in connection with the Program, each participant (including the Insured Participant) will enter into a separate protected cell program agreement with the Company with respect to the Protected Cell, thereby becoming a participant in the Protected Cell (each a “**Participant**,” and collectively, the “**Participants**”); and



WHEREAS, in connection with the Program, the Insured Participant is desirous of entering into this protected cell program agreement (the “**Agreement**”), setting forth, among other things, the terms upon which the Insured Participant will share on a mutual basis in the Protected Cell’s financial results, and the Company is desirous of making the benefits and liabilities of the Protected Cell available to the Insured Participant upon the terms of this Agreement.

NOW, THEREFORE, in consideration of the mutual terms, covenants and conditions contained herein, the parties hereto agree as follows:

## **1. Selected Definitions**

Capitalized terms used in this Agreement but not defined herein shall have the meanings given to them in the NC Captive Act.

“Insurer” means Berkley Life and Health Insurance Company.

“Policy Year” means the period from the effective date to the termination date of the Reinsurance Agreement between the Company, for and on behalf of the Protected Cell, and the Insurer, which ordinarily shall be a twelve calendar month period.

“Reinsurance Agreement” means the reinsurance agreement between the Company, for and on behalf of the Protected Cell, and the Insurer that defines the manner in which each will cede or assume some or all of the risk(s) and premium(s) under the Stop-Loss Policies issued to each Participant by the Insurer.

“Gross Subject Premiums” for each Policy Year will be the final adjusted gross written premium for the Participant’s Stop-Loss Policy.

“Investment Income” is income from the invested assets identified with and attributed to the Protected Cell with respect to the Policy Year, net of all fees, expenses and investment losses identified with and attributed to the Protected Cell.

“Losses” means all liabilities and estimated liabilities assumed under the Reinsurance Agreement, whether incurred or deemed by the Company in its sole discretion as likely to be incurred, subject to the Company’s limit of liability under the Reinsurance Agreement for all reinsured Stop-Loss Policies.

“Expenses” means all expenses and charges, excluding “Losses,” identified with and attributed to the Protected Cell, including, but not limited to, any amount not collected under any letter of credit provided by any Participant of the Protected Cell to the extent such deficiency is not paid in cash by such Participant or any taxes attributable to the Protected Cell.

“Pro Rata” share means the ratio of a Participant’s Initial Funding and Contingent

Funding for that Policy Year to the aggregate Initial Funding and Contingent Funding for all of the Participants for that Policy Year.

## 2. Protected Cell

2.1 Establishment of the Protected Cell. The Company will establish and operate the Protected Cell, in accordance with the NC Captive Act (including the segregation requirements contained therein) and as more fully described herein, and the Company, acting for and on behalf of the Protected Cell, will enter into the Reinsurance Agreement with the Insurer to reinsure the Stop-Loss Policies associated with the Protected Cell.

2.2 NC Captive Act. The parties understand and acknowledge that the Company is licensed under the NC Captive Act and that the NC Captive Act affects the rights and obligations of the parties to this Agreement. For the avoidance of doubt, the parties further understand and agree that:

2.2.1 This Agreement is a “participant contract” under the NC Captive Act;

2.2.2 The Insured Participant is a “participant” under the NC Captive Act;

2.2.3 The Protected Cell is a “protected cell” under the NC Captive Act; and

2.2.4 All premiums ceded and liabilities assumed under the Reinsurance Agreement are identified with and attributed to the Protected Cell.

## 2.3 Segregation of Resources.

2.3.1 Protected Cell Resources. The resources of the Protected Cell (the “**Protected Cell Resources**”) include, without limitation, all property, assets, contract rights, general intangibles, undistributed profits, collectible reinsurance, insurance and reinsurance premiums, and interest or other income identified with and attributed to the Protected Cell by the Company, in its books and records, as being resources available to pay any Losses, Expenses or any other claims, liabilities, expenses or other charges identified with and attributed to the Protected Cell.

2.3.2 Segregation Requirements. The Company shall operate the Protected Cell in accordance with the requirements of the NC Captive Act. The Company shall maintain separate books and records for each of its protected cells, including the Protected Cell. All items of income and expense identified with and attributed to each such protected cell shall be recorded in the books and records for such protected cell, which shall be maintained in accordance with North Carolina law and generally accepted

accounting principles consistently applied. The Protected Cell Resources shall be kept separate and separately identifiable from all other resources, funds and assets of the Company within the meaning of the NC Captive Act. Protected Cell Resources shall be held in the applicable segregated account for the purpose of satisfying the obligations of that protected cell and shall not be available or used to pay any claims, expenses, liabilities or other charges identified with or attributed to any other protected cell or the general account of the Company, except as expressly set forth herein.

2.3.3 Limitations on Resources. The Insured Participant acknowledges that, regardless of whether the Protected Cell Resources have been exhausted,

(a) the Insured Participant and the other creditors of the Protected Cell shall have recourse only to the Protected Cell Resources,

(b) the Insured Participant and the other creditors of the Protected Cell shall not have recourse to any assets identified with or attributed to any other protected cell of the Company, except where all relevant parties may expressly agree otherwise and in accordance with applicable law,

(c) the Insured Participant and the other creditors of the Protected Cell shall not have recourse to the general account of the Company, and

(d) the Company shall not have any obligation whatsoever to use any of the general account's property, assets or resources to satisfy any Losses, Expenses or any other claims, liabilities, expenses or other charges identified with or attributed to the Protected Cell.

### 3. Administration of the Protected Cell

3.1 General Administration. The Company's business and affairs (including with respect to the management and administration of the Protected Cell) shall be managed by or under the direction of its Board of Directors (the "**Board**"), which may delegate such duties as it deems appropriate to others, including the Company's officers and the captive manager.

3.2 No Participation in Management. The Insured Participant shall have no authority whatsoever to manage, bind or otherwise represent the Company or the Protected Cell, or have any voting or other rights in the Company or the Protected Cell not specifically set forth in this Agreement or the NC Captive Act.

3.3 Management, Administrative Fees and Expenses. The Insured Participant shall pay the fees set out in Schedule 1, and the Company shall charge to and pay directly from the Protected Cell Resources all fees and expenses identified with and attributed to the Protected Cell. The Management Fee and the Administrative Fee do not cover or include expenses identified with or attributed to the Protected Cell; they only cover expenses directly associated

with the operation of the Company. To the extent expenses identified with or attributable to the Protected Cell are paid out of the Company's general account, the Protected Cell shall promptly reimburse the Company for such expenses. The Company shall be entitled to deduct all such reimbursement amounts from Protected Cell Resources from time to time, in its sole discretion, and shall provide the Participants with an accounting therefor annually (or more frequently, in the Company's sole discretion.)

3.4 Reports and Records. The Company shall comply with all record-keeping requirements set forth in the NC Captive Act. The Company will provide the Insured Participant with an income statement and balance sheet concerning the Protected Cell on a quarterly or semi-annual basis, as determined in the Company's sole discretion. The records maintained by the Company with respect to the Protected Cell may be inspected at the Company's office by the Insured Participant at its own expense after giving reasonable advance written notice to the Company, but the Insured Participant shall not have the right to inspect the records relating to any other protected cell or segregated account, or the general account of the Company.

3.5 Waiver of Rights. The Insured Participant hereby waives any right it might have to be provided with any independent auditor's report in respect of the financial statements of the Protected Cell or of the Company. This waiver will remain in place for an indefinite period but is revocable at the option of the Insured Participant on written notification to the Company. If the Insured Participant at any time revokes the waiver set out in this clause, then upon reasonable advance written notice to the Company, and at the sole expense of the Insured Participant, the Insured Participant shall be entitled to audit the financial records associated directly with the Protected Cell at the Company's office, for the Policy Year or Policy Years that the Insured Participant was a Participant in the Protected Cell.

3.6 Obligation to Provide Information. The Insured Participant shall promptly cooperate with and assist the Company in the collection of any information necessary to enable the Company to make decisions relating to the business or operation of the Company or of the Protected Cell or to comply with any legal or regulatory obligations of the Company or of the Protected Cell.

#### **4. Funding**

4.1 Purchase of Stop-Loss Insurance. The Insured Participant shall (i) purchase from the Insurer a Stop-Loss Policy in connection with the Program, which is intended to be reinsured by the Company, acting for and on behalf of the Protected Cell, and (ii) promptly pay when due all sums that become due under such Stop-Loss Policy and this Agreement. Neither the cancellation, suspension, termination or the void or voidable status of the Stop-Loss Policy shall relieve the Insured Participant of its obligations under this Agreement.

## 4.2 Initial Funding.

4.2.1 The Insured Participant shall provide to the Company the amount specified in Schedule 2 (the “**Initial Funding**”) immediately upon receipt of an invoice. The parties understand and agree that the payment of the Initial Funding will be used to fund the Protected Cell’s operations, including collateralizing the Protected Cell’s obligations to the Insurer under the Reinsurance Agreement. The Initial Funding is a Protected Cell Resource and shall be provided in such form, whether cash, letter of credit or otherwise, that complies with the NC Captive Act and is acceptable to the Company.

4.2.2 The Company’s obligation pursuant to Sections 7.3 and 7.5 to return the Initial Funding, or part thereof, shall be subordinate to the Company’s obligation to satisfy out of Protected Cell Resources any Losses, Expenses or other claims, liabilities, expenses or other charges deemed necessary or appropriate by the Company in its sole discretion with respect to the Protected Cell for the Policy Year for which such Initial Funding was provided, and shall be subject to the requirements of applicable law and the Company’s right of offset under Section 4.5.

4.2.3 The Insured Participant shall have no interest in any Protected Cell Resources or in any assets identified with or attributed to any other protected cell, segregated account associated therewith, or the general account of the Company by virtue of being a counterparty to this Agreement, by its status as a Participant, or by its payment of the Initial Funding, except that the Insured Participant may have an interest, in its capacity as the payer of Stop-Loss Policy premiums that are reinsured to the Protected Cell and as an Insured Participant, in distributions from the Protected Cell, if and when declared by the Board in accordance with this Agreement or the Company’s return of Funding under Sections 7.3 and 7.5.

## 4.3 Contingent Funding.

4.3.1 The Insured Participant shall provide to the Company the amount(s) determined pursuant to the formula specified in Schedule 3, which amounts shall include, among other things, any amounts required to collateralize the Protected Cell’s obligations to the Insurer under the Reinsurance Agreement (the “**Contingent Funding**,” and together with the Initial Funding, the “**Funding**”) immediately upon receipt of an invoice. The Company may only require payment of the Contingent Funding in accordance with the terms specified in Schedule 3. The Company, in its sole discretion, will determine when and if to invoice the Insured Participant for the Contingent Funding it determines is required from time

to time; *provided, however*, that any decision to delay or not to invoice or require payment of the Contingent Funding shall not operate or be construed as a waiver of any present or future requirement to provide such Contingent Funding as the Company may determine from time to time. The Contingent Funding is a Protected Cell Resource and shall be provided in such form, whether cash, letter of credit or otherwise, that complies with the NC Captive Act and is acceptable to the Company in its reasonable discretion.

4.3.2 The Company's obligation pursuant to Sections 7.3 and 7.5 to return the Contingent Funding, or part thereof, shall be subordinate to the Company's obligation to satisfy out of Protected Cell Resources any claims, expenses, liabilities, or other charges deemed necessary or appropriate by the Company in its sole discretion with respect to the Protected Cell for the Policy Year for which such Contingent Funding was provided, and shall be subject to the requirements of applicable law and the Company's right of offset under Section 4.5.

4.3.3 The Insured Participant shall have no interest in any Protected Cell Resources or in any assets identified with or attributable to any other protected cell, segregated account or to the Company's general account by virtue of being a counterparty to this Agreement, its status as a Participant, or its payment of the Contingent Funding, except that the Insured Participant may have an interest, in its capacity as the payer of Stop-Loss Policy premiums that are reinsured to the Protected Cell and as an Insured Participant, in distributions from the Protected Cell, if and when declared by the Board in accordance with this Agreement or the Company's return of Funding under Sections 7.3 and 7.5.

4.4 Unpaid Funding. Amounts owed pursuant to Sections 4.2 and 4.3 but unpaid for more than thirty (30) days shall bear interest at an annual rate of 5%, computed on the basis of a 360-day year and commencing from the date the payment was due. In addition, in the event the Company deems it necessary to retain counsel to enforce the terms of this Agreement, the reasonable costs and expenses incurred by the Company, or by the Protected Cell as the case may be, including legal fees, shall be part of the Insured Participant's liabilities to Company, or the Protected Cell as the case may be, and shall be payable by the Insured Participant on demand.

4.5 Right of Offset. Any unpaid Funding owed by the Insured Participant with respect to a Policy Year will affect the Insured Participant's right to receive a distribution pursuant to Section 5.2 with respect to that Policy Year, and the Company may offset such unpaid Funding against any distributions declared or return of Funding provided with respect to a different Policy Year that the Insured Participant would otherwise have been eligible to receive. For the avoidance of doubt, to the extent any of the amounts paid by the Insured Participant pursuant

to Section 4.2 or 4.3 with respect to any Policy Year are subject to a refund by the Company pursuant to Section 7.3 or Section 7.5, any such amounts may be used to pay or offset the Insured Participant's obligations under Section 4.2 or 4.3 with respect to any other Policy Year.

4.6 Authority; Insurance Regulation. The Insured Participant shall have no authority to act on behalf of or otherwise represent the Company or the Protected Cell. The Insured Participant shall not take any actions which might cause the Company or the Protected Cell to be deemed to be transacting insurance or reinsurance business in jurisdictions where the Company is not licensed.

4.7 Premiums and Rating. The Insurer will determine and set the premiums to be ceded and the risks to be assumed under the Reinsurance Agreement. It is intended that the sum of the premiums ceded under the Reinsurance Agreement together with the Initial Funding to be provided by the Participants will equal or exceed the liabilities assumed under the Reinsurance Agreement.

## 5. Distributions and Other Financial Matters

5.1 Distributions from Surplus. The Company's results identified with and attributed to the business of the Protected Cell for each Policy Year will be calculated in accordance with applicable law, generally accepted accounting principles consistently applied, and such other principles and requirements as are specified in this Agreement, as it may be amended from time to time. The results shall be allocated by the Company to the Protected Cell's surplus established for each Policy Year.

### 5.2 Determination of Interests in Distributions.

5.2.1 Distributions for the Policy Year ("**PIP Distributions**"), if any, will be declared at the Board's discretion and shall only be paid out of the Protected Cell's available surplus for that Policy Year in accordance with applicable law, the formula set forth in Schedule 4, and the terms of this Agreement.

5.2.2 To be eligible to receive a PIP Distribution, the Insured Participant must be a Participant in good standing in the Protected Cell for that Policy Year. At the time the distribution is declared and paid, the Insured Participant must be a Participant in good standing in the Protected Cell and its status as such must not have been terminated pursuant to Section 7.1 or 7.2.

5.2.3 The Company may use any PIP Distribution declared and otherwise payable to the Insured Participant with respect to any Policy Year to offset and satisfy any amounts the Insured Participant owes with respect to any other Policy Year to the Company or to the Protected Cell under this Agreement or that the Insured Participant owes to the Insurer with respect to a Stop-Loss Policy reinsured by the Company in respect of Protected Cell.

5.2.4 If the Company determines in its sole discretion that the Insured Participant is in default of this Agreement or any other agreement with the Company or Protected Cell, or under any Stop-Loss Policy reinsured by the Company in respect of the Protected Cell or another protected cell, the Company may use any PIP Distribution declared and otherwise payable to the Insured Participant with respect to any Policy Year to discharge or cure any such default.

5.2.5 The Board shall not declare or pay a PIP Distribution if it has reasonable grounds for believing that (i) the Protected Cell's available surplus with respect to the Policy Year for which the distribution is being considered is or will be insufficient to pay the distribution, (ii) the Protected Cell is or after payment of the distribution would be insolvent as determined under applicable law or (ii) the realizable value of the aggregate of the Protected Cell Resources for all Policy Years would thereafter be less than the aggregate of its liabilities for such years.

5.3 Interest in Distributions. As an Insured Participant and as a payer of Stop-Loss Policy premiums that are reinsured to the Protected Cell, the Insured Participant may have an interest in the Protected Cell's surplus for the current Policy Year if and when a PIP Distribution is declared by the Board for the Policy Year. But the Insured Participant shall have no interest, by virtue of its status as an Insured Participant in the current Policy Year, or as a signatory to this Agreement, in any other Protected Cell Resources attributable to any other Policy Year or in any assets identified with or attributed to any other protected cell of the Company or to the Company's general account.

5.4 Restriction on Transfer & Assignment of Rights. This Agreement and the rights and interests of the Insured Participant under it shall not be pledged or hypothecated and shall not be transferred or assigned; *provided, however*, if the Insured Participant is merged, consolidated or substantially all of its assets are sold to another company, the Board may in its sole discretion permit the transfer of such rights and interests to the successor of the Insured Participant, if such successor becomes a Participant by executing a protected cell program agreement substantially in the form of this Agreement and assumes all the Insured Participant's obligations in connection with the Program and under this Agreement.

## **6. Actions Against the Company or its Directors or Officers**

6.1 Waiver of Claims. The Insured Participant waives any claim or right of action it might have, whether individually or by or in the right of the Company, against any director or officer of the Company on account of any action taken by such director or officer or the failure of such director or officer to take any action in the performance of his duties with or for the Company to the fullest extent permitted by applicable law. Such waiver, however, shall not extend to any



matter in respect of any willful misconduct, fraud or dishonesty which may attach to such director or officer. An action against the Company shall be deemed to be an action against its directors or officers.

6.2 Indemnification. The Company and each director, officer and other agent or representative of the Company acting with respect to the Protected Cell, including the captive manager, shall be indemnified and held harmless out of the Protected Cell Resources against all actions, proceedings, Losses, Expenses, and any other liabilities, losses, damages, costs, charges and expenses which they may incur or suffer by reason of any act done, concurred in or omitted in the conduct of or in connection with the Program, the Company, acting for and on behalf of the Protected Cell, or the Protected Cell. The Company shall charge the Protected Cell for the costs of any such indemnification; if there are insufficient Protected Cell Resources, such amounts will be assessed and invoiced to the Insured Participant and each other Participant as an expense of the Protected Cell pursuant to Section 4.3. This indemnity shall not extend to any matter in which the Company, a director, officer or Protected Cell agent or representative shall have been determined by a court of competent jurisdiction to be liable for willful or intentional misconduct in the performance of its duties with respect to the Company or the Protected Cell.

## 7. Termination

7.1 Termination of Insured Participant Status. This Agreement and the status of the Insured Participant as such with respect to the Protected Cell may be terminated on written notice given by the Company or the Insured Participant ninety (90) days prior to the anniversary date of a Policy Year, with such termination effective on the date specified in the notice, but in no event earlier than such anniversary date. In addition, the Insured Participant's status as such will automatically terminate at the end of a Policy Year if the Insured Participant has not entered into a protected cell program agreement for the next succeeding Policy Year and satisfied all of the other conditions required to be a Participant for such succeeding year.

7.2 Termination of Insured Participant Status for Cause. The status of the Insured Participant as such with respect to the Protected Cell:

7.2.1. Shall be terminated automatically and immediately if the Insured Participant is wound up or dissolved or ceases to be an insured under a current Stop-Loss Policy that is reinsured under the Reinsurance Agreement, or

7.2.2. May be terminated on thirty (30) days prior notice by the Company upon breach of any obligation undertaken by the Insured Participant under this Agreement or under any Stop-Loss Policy reinsured by the Company, acting for and on behalf of the Protected Cell.

7.2.3 May be terminated on thirty (30) days prior notice by the Company upon the Insured Participant (1) being put into bankruptcy or is bankrupt, placed into receivership, liquidated, dissolved, or the financial condition of the Insured Participant is adversely affected as determined by the Board, (2) being merged or amalgamated with another entity or selling, leasing, transferring or otherwise disposing of a material portion of its assets or having a controlling interest in it sold or transferred, (3) making a general assignment for the benefit of its creditors or an arrangement pursuant to any bankruptcy law, (4) applying for the appointment, consenting to the appointment or failing to have removed within thirty (30) days after appointment of a receiver, trustee, custodian, sequestrator, liquidator or similar official for itself or any of its assets or properties, (5) failing or being unable, or admitting in writing its inability, to pay its debts generally as they become due, (6) concealing, removing or transferring any of its assets or properties in violation or evasion of any bankruptcy, fraudulent conveyance or similar applicable law, (7) discontinuing its business, or (8) taking any action for the purpose of effecting any of the actions set forth in this clause.

7.3 Consequences of Termination of Insured Participant Status. In the event the Insured Participant has its status as such terminated in accordance with Sections 7.1 or 7.2 in circumstances where the Protected Cell is not terminated, the Company, acting for and on behalf of the Protected Cell, will, if applicable, cease assuming reinsurance with respect to the Insured Participant and, subject to applicable law and the right of offset under Section 4.5, will return to the Insured Participant any Funding the Insured Participant previously provided, but only to the extent such Funding has not been used and is not and will not be needed by the Company to pay losses, expenses or any other charges deemed necessary or appropriate by the Company in its sole discretion with respect to the Protected Cell for the Policy Years for which such Funding was provided. Notwithstanding termination of the Insured Participant's status as such pursuant to Sections 7.1 or 7.2, the Company, acting for and on behalf of the Protected Cell, shall remain liable for its obligations under the Reinsurance Agreement and the Insured Participant shall remain liable for its obligations under Sections 4.2 and 4.3.

7.4 Termination of the Protected Cell. The Protected Cell and its segregated account may be terminated, subject to applicable law and all required regulatory approvals:

(a) by the Company or by Participants representing a majority of the annual premiums ceded to the Protected Cell under the Reinsurance Agreement for the current Policy Year, on written notice given not less than ninety (90) days prior to the anniversary date or renewal date of the Reinsurance Agreement, with such termination effective on the date

specified in the notice, but in no event earlier than such anniversary or renewal date.

(b) by the Company in its sole discretion, if the Board determines that the Company's experience with respect to the Protected Cell is excessively adverse, or that the business ceded to the Company with respect to the Protected Cell fails to meet the standards determined by the Board.

7.5 Consequences of Termination of the Protected Cell. Upon the termination of the Protected Cell:

- (a) the Company, acting for and on behalf of the Protected Cell, shall not reinsure any additional Stop-Loss Policies under the Reinsurance Agreement and shall not enter into any new Reinsurance Agreements with respect to the Protected Cell, but shall remain liable for its obligations under the Reinsurance Agreements previously issued with respect to the Protected Cell in accordance with the terms of such Reinsurance Agreements. The Insured Participant shall not have any recourse, except as determined by the Company in its sole discretion under Section 7.5(c), to any Funding provided pursuant to Sections 4.2 and 4.3 and shall remain liable for its obligations under those Sections.
- (b) The net amount of the Protected Cell Resources shall be determined by the Company in accordance with applicable law and generally accepted accounting principles consistently applied.
- (c) Subject to applicable law and the right of offset under Section 4.5, the Company shall return to the Insured Participant any Funding the Insured Participant previously provided, but only to the extent such Funding has not been used and is not and will not be needed by the Company, acting for and on behalf of the Protected Cell, to pay any Losses, Expenses or any other claims, liabilities, expenses or any other charges deemed necessary or appropriate by the Company in its sole discretion with respect to the Protected Cell for the Policy Years for which such Funding was provided.
- (d) Subject to applicable law, any required regulatory approvals, and the right of offset under Section 4.5, the Board, in its sole discretion, may declare a distribution out of the remaining Protected Cell Resources, if it determines that the payment of such distribution would not impair the Company's ability using Protected Cell Resources to meet the remaining obligations relating to the Protected Cell. The payment and allocation of any such distribution shall be subject to all other provisions of this Agreement, including Section 5.2.

7.6 Survival. For the avoidance of doubt, the terms of Sections 2 (Protected Cell), 3.5 (Waiver of Rights), 4 (Funding), 6 (Actions Against the Company or its Directors or Officers), 9 (Governing Law and Dispute Resolution) and 11.1 (Confidentiality) shall survive the termination of the Protected Cell and of this Agreement.

## 8. Representations and Warranties

8.1 The Company and the Insured Participant each hereby represents and warrants to the other:

- (a) That it is a [corporation] in good standing in the place of its organization, and has all necessary licenses, permits and other governmental and regulatory authority to carry on its business as presently conducted and to perform its obligations under this Agreement;
- (b) That the execution, delivery and performance of this Agreement has been duly authorized by all required corporate or other necessary action; and
- (c) That this Agreement, upon execution and delivery, constitutes a legal, valid and binding obligation of the Company, or the Insured Participant, as the case may be, and will be enforceable against it in accordance with the terms hereof, except as such enforcement may be affected by bankruptcy, reorganization, insolvency or other laws generally relating to the rights of creditors in effect from time to time.

8.2 The Insured Participant represents and warrants to the Company:

8.2.1 Non-Reliance. That the Insured Participant is acting for its own account, and it has made its own independent decisions to enter into this Agreement and to participate in the Protected Cell and as to whether participation in the Protected Cell is appropriate or proper for it based on its own judgment and upon advice from its own advisors as it has deemed necessary. It is not relying on any communication (written or oral) of the Company or of the Company's agents, representatives or affiliates in relation to whether or not to participate in the Protected Cell; it being understood that information and explanations related to the terms and conditions of this Agreement or the Protected Cell are not and shall not be considered a recommendation to participate in the Protected Cell. No communication (written or oral) received from the Company shall be deemed to be an assurance or guarantee as to the expected results of participation in the Protected Cell.

8.2.2 Assessment and Understanding. The Insured Participant has: (i) sufficient knowledge and experience in financial, business, tax and insurance matters to assess and evaluate the merits, terms, conditions and risks of participation in the Protected Cell or has sought and received

independent professional advice from advisors with such knowledge and experience; and (ii) had the opportunity to take advice and to obtain all such additional information that it considers necessary to evaluate the terms, conditions and risks of participation in the Protected Cell.

8.2.3 Status of Parties. That the Company is not acting as a fiduciary for or an advisor to the Insured Participant or to any other Participant with respect to the Program or participation in the Protected Cell.

8.2.4 That the Insured Participant has read this Agreement and acknowledges and understands that this Agreement is subject to the provisions of the NC Captive Act.

8.2.5 That the Insured Participant is aware that the IRS may successfully contend that the intended federal income tax treatment of the Company and each Protected Cell is inappropriate and that changes in the applicable federal income tax law or the interpretations of the applicable federal income tax law could have an adverse impact on the Company, the Protected Cell and/or the Insured Participant.

8.2.6 The Insured Participant is capable of assuming the financial risks inherent in participation in the Protected Cell, including the risk of becoming obligated to pay the Contingent Funding pursuant to Section 4.3 and of the Funding being held for an indefinite period of time.

8.2.7 That the Insured Participant acknowledges and understands that no federal, state or foreign authority, including any insurance regulatory body, has conducted a formal review of the transaction described by this Agreement or of any of the documents or materials provided to the Insured Participant concerning participation in the Protected Cell, or has passed upon or endorsed the merits or risks of participating in the Protected Cell or the accuracy or adequacy of any of the various documents and materials.

8.2.8 That the Insured Participant is entering into this Agreement based solely on the terms of this Agreement and not on any other verbal or written representations, facts, projections, promises, or information.

8.2.9 That the Insured Participant understands that it has no voting or similar rights in respect of the Company or of the Protected Cell, and that it will not be able to exercise any management or control with respect to the business or operations of the Company or of the Protected Cell.

8.2.10 That the Insured Participant's participation in the Protected Cell will not breach any laws or regulations, including applicable money laundering rules and regulations, and the documentation that the Insured Participant

has provided to verify its identity to the Company is complete and accurate in all respects.

8.2.11 The Insured Participant has provided complete and accurate information to the Insurer in connection with the underwriting and issuance of the Stop-Loss Policy reinsured under the Reinsurance Agreement.

8.2.12 That the Insured Participant will notify the Company immediately if any representation or warranty under this Agreement is no longer accurate and complete or if it has failed to comply with an undertaking hereunder.

## **9. Governing Law and Dispute Resolution**

9.1 This Agreement shall be construed and enforced in accordance with and governed by North Carolina law. The negotiation and execution of this Agreement, as well as any other contract, on behalf of the Company will be conducted solely by the Company's officers or the captive manager, subject to Board approval if necessary, in North Carolina.

9.2 The Company and the Insured Participant wish to resolve any disputes arising under this Agreement, including, for the avoidance of doubt, disputes in relation to the Protected Cell, without resort to litigation in order to protect the confidentiality of their relationship and their respective businesses and affairs. Any dispute, controversy or claim arising out of or related to this Agreement or to the breach, termination or invalidity thereof (including claims for injunctive relief or prejudgment security), shall be fully settled by final and binding arbitration in New York, New York in accordance with the procedures provided herein and the then-prevailing rules of the American Arbitration Association or its successor (the "**Rules**"), except that the procedures mandated by such Rules shall be modified as provided herein. In the event of a conflict between this Agreement and the Rules, the provisions of this Agreement shall control.

9.3 Without in any way limiting clause 9.2 above, all disputes between the parties relating to or arising in connection with (i) the execution and delivery, construction or enforceability of this Agreement, (ii) the management or operations of the Company or of the Protected Cell, or (iii) any other breach or claimed breach of this Agreement or the transactions contemplated herein shall be submitted to arbitration after, in the first instance, good faith discussion among the parties hereto seeking to settle any such dispute. In the event that a settlement is not reached within twenty-eight (28) days of initiation thereof, or such extended period as the parties may otherwise agree in writing, then the dispute shall be referred to arbitration in accordance with the Rules and clause 9.2 above. If and to the extent all or any part of any dispute under clause 9.2 is determined not to be subject to this arbitration agreement, the Insured Participant agrees that litigation as to the non-arbitrable dispute will not be commenced or, in the alternative, will be stayed until arbitration as to the other disputes has

concluded and a Final Decision under clause 9.9 is delivered by the arbitration panel.

9.4 Subject to clause 9.3 above, either party may initiate arbitration by serving written demand upon the other party or parties. The demand shall state in summary form the issues in dispute in a manner that reasonably may be expected to apprise the other party of the nature of the controversy and the particular damage or injury claimed. The party receiving the demand shall answer in writing within twenty-eight (28) days and include in such answer a summary of any additional issues known or believed to be in dispute by such party described in a manner that reasonably may be expected to apprise the other party of the nature of the additional issues in controversy and the particular damage or injury claimed.

9.5 All matters shall be decided by a panel of three arbitrators, all of whom must be either current or former disinterested, impartial and neutral officers or directors of Life, Health and Accident insurers or current or former insurance brokers or administrators or disinterested impartial and neutral executive officers of insurance or reinsurance companies not under the control and without past employment or directorial relationships to any party to this Agreement. Each party shall elect its own party arbitrator, and the parties' chosen arbitrators shall meet within ten (10) business days after the second arbitrator is appointed and jointly select the third arbitrator. In the event that the two party-chosen arbitrators cannot agree on the third arbitrator within five (5) business days after the expiration of the ten (10) business day period, each party shall appoint three candidates, two of whom shall be stricken by the other party, and the third arbitrator shall thereafter be chosen from the remaining two candidates by the drawing of lots. If either party fails to notify the other of the appointment of such party's arbitrator within the time specified, then the arbitrator appointed by the other party shall be the sole arbitrator to determine the disputed matters. Judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction. The potential arbitrators shall be advised of all the provisions of this arbitration clause and no potential arbitrator may be appointed unless such arbitrator has agreed in writing to the terms of this arbitration provision.

9.6 Discovery shall be permitted in connection with the arbitration only to the extent, if any, expressly authorized by the arbitration panel upon a showing of substantial need by the party seeking such discovery. The arbitrator shall have the authority to conduct conferences and hearings, hear arguments of the parties and take the testimony of witnesses. All witnesses will be made available for cross-examination by the parties. The arbitration panel may order the parties to exchange information or make witnesses available to the opposing party prior to any arbitration hearing. For the avoidance of doubt, any discovery permitted shall be limited to the dispute that is the subject of the arbitration.

9.7 Within forty (40) days following the date of appointment of the final arbitrator, each party shall submit to the arbitration panel and shall exchange with each other a presentation of its case and its last, best settlement offer. The arbitration panel shall be limited to awarding only one of the two settlement offers submitted. If one party fails to exchange or provide to the arbitration panel its last, best settlement offer, within the time required, the arbitration panel shall be bound to award the settlement offer which was submitted by the other party and no arbitration hearing will occur. In no event may the arbitration panel award punitive, exemplary or enhanced compensatory damages. Notwithstanding the foregoing, the arbitration panel may award interest and costs.

9.8 The arbitration panel may request an arbitration hearing within twenty (20) days after both parties have submitted their respective presentations and their last, best settlement offer. If the arbitration panel requests a hearing, such hearing shall be held no less than twenty (20) days but not more than forty-five (45) days from the date the arbitration panel requests such hearing. Ex parte communications with the arbiter is prohibited prior to the issuance of the final award.

9.9 The arbitration panel shall deliver a written reasoned decision and award of the majority of the arbitrators (the “**Final Decision**”) within ten (10) days of the close of the arbitration proceeding which shall be deemed to be the later of (i) the last day on which evidence is heard by the arbitration panel or (ii) the final date briefs and position statements are submitted by each party. Within fifteen (15) days after the Final Decision is delivered, the parties shall take all actions on their part necessary to implement the Final Decision.

9.10 Either party may apply to court of competent jurisdiction for an order confirming any final award of a majority of the arbitrators; a judgment of that court shall thereupon be entered on any award. If the application for confirmation is contested and a judgment is issued confirming the award, then party against whom confirmation is sought shall pay the attorney's fees of the party who applied for the confirmation and all court costs of such proceeding. The Insured Participant consents to the jurisdiction of the United States district courts located in the County of New York for purposes of enforcement of any Final Decision.

9.11 The award of the majority of the arbitrators shall be final, binding and conclusive on the parties, and no disclosure of any aspect of the arbitration or of the award shall be made public except as required by law or regulation or as necessary or appropriate to effect the enforcement thereof. Before making any such disclosure, a party shall give written notice to the other party and shall afford such other party a reasonable opportunity to protect its interests.

9.12 Pending the Final Decision and any award which might be made on costs, each party will equally share the fees and expenses of the arbitrators, the administration fees and expenses of the American Arbitration Association (if any)



and any other administrative expenses incurred in connection with the arbitral proceedings.

9.13 The reference to this arbitration clause in any specific provision of this Agreement is for emphasis only, and is not intended to limit the scope, extent or intent of this arbitration clause, or to mean that any other provision of this Agreement shall not be fully subject to the terms of this arbitration clause.

9.14 This arbitration clause shall survive the termination of this Agreement and be deemed to be an obligation of the parties which is independent of, and without regard to, the validity of this Agreement.

## 10. Notices

10.1 All notices, requests, demands or other communications required or permitted to be given hereunder shall be in writing and shall be delivered by facsimile, by hand, by first class mail, or by internationally recognized private overnight carrier with proof of delivery, addressed to the address for service of the parties as follows:

If to the Insured Participant:

Address: [ \_\_\_\_\_ ]  
Fax: [ \_\_\_\_\_ ]  
Attn: [ \_\_\_\_\_ ]

With a copy to:

Address: [ \_\_\_\_\_ ]  
Fax: [ \_\_\_\_\_ ]  
Attn: [ \_\_\_\_\_ ]

If to the Company:

Address: Oak Harbor Reinsurance Company, in respect of its  
Protected Cell Program No. \_\_\_\_-\_\_\_\_  
101 S. Tryon Street, Suite 2700  
Charlotte, NC 28280

Fax: \_\_\_\_-\_\_\_\_-\_\_\_\_\_  
Attn: \_\_\_\_\_

With a copy to:

Address: Strategic Risk Solutions  
Captive Manager for Oak Harbor Reinsurance Company  
101 S. Tryon Street, Suite 2700  
Charlotte, NC 28280

Fax: \_\_\_\_ - \_\_\_\_ - \_\_\_\_

10.2 Unless shown to have been received earlier, any such notice so delivered shall be deemed to have been given:

- (a) if delivered by hand, when delivered, if delivered during the recipient's normal business hours, or if delivered outside such hours, at the opening of business on the recipient's next business day;
- (b) if delivered by facsimile, three hours after the time of transmission, if transmitted during the recipient's normal business hours, or if delivered outside such hours, at the opening of business on the recipient's next business day; or
- (c) if mailed by a recognized mailing service, three days after the date of mailing, unless the notice was mailed during postal strike or other postal disruption, in which case the notice shall be deemed to have been received within three days after the resumption of normal mail service.

10.3 Any party may change the name and address to which notices, requests, demands or other communications are given pursuant to this Agreement by written notice given to the other party in the manner specified in this Section above.

## 11. Other Matters

11.1 Confidentiality. The Company and the Insured Participant shall each keep confidential and refrain from the use of information submitted to it by the other in connection with this Agreement or the operations of the Company or of the Protected Cell, except to the extent that disclosure or use of such information is necessary for the conduct of the Company's operations or is otherwise required by law or regulation. Each party shall take reasonable steps to safeguard the confidentiality of the information so disclosed to it and shall require its representatives, agents and employees to do likewise. Notwithstanding any other express or implied agreement, arrangement, or understanding to the contrary, each party to this Agreement (and its employees, representatives, and agents) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure and any fact that may be relevant to understanding such tax treatment or structure and all materials of any kind (including opinions or other analyses) that are provided to the parties relating to such tax treatment or structure.

11.2 Tax Matters. The Insured Participant agrees and acknowledges that the Company has the sole discretion to select the tax compliance and tax return preparation provider for the Protected Cell. The Insured Participant further agrees and acknowledges that the Protected Cell shall have no recourse to the assets of other protected cells or the general account of the Company in order to

satisfy tax liabilities of the Protected Cell. The Insured Participant further agrees and acknowledges that the general account of the Company may charge the Protected Cell for the amount of any tax liabilities a taxing authority requires the Company to pay relating to the Protected Cell.

11.3 Counterparts. This Agreement may be executed in counterparts both of which, taken together, shall constitute one instrument.

11.4 Amendment and Waiver. This Agreement may be amended, or a provision of it may be waived, but only with the written consent of the parties hereto.

11.5 No Third Party Beneficiaries. This Agreement does not confer any rights or remedies upon any person other than the parties hereto.

11.6 Binding Effect. All the terms and provisions of this Agreement shall be binding upon and inure to the benefit of the Insured Participant and its legal representatives and the Company and its successors.

11.7 Waiver of Breach. The waiver by either party of a breach of any provision of this Agreement by the other shall not operate or be construed as a waiver of any subsequent breach.

11.8 Headings. The headings in this Agreement are for convenience only and shall not be deemed to constitute a part of this Agreement, nor shall they affect the construction or interpretation of any provision of this Agreement.

11.9 Severability. If any provision of this Agreement is invalidated for any reason whatsoever, this Agreement shall remain binding between the parties and in full force and effect except for such invalidated provision. If any injustice shall result therefrom, however, the parties shall negotiate in good faith to provide adjustments to ameliorate the effects of such injustice.

11.10 Schedules. The Schedules 1 through 4 attached hereto are incorporated into and form an integral part of this Agreement.

11.11 Entire Agreement. This Agreement, including [the](#) Schedules, contains the complete and final agreement of the parties with respect to the subject matter of this Agreement and supersedes all prior or contemporaneous negotiations, representations, agreements and undertakings, in whatever form, with respect thereto.

IN WITNESS WHEREOF, the parties have caused this Agreement to be duly executed by their authorized representatives.

[Insert Name of Insured Participant]

By: \_\_\_\_\_

Its: \_\_\_\_\_

ATTEST:

By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

OAK HARBOR REINSURANCE COMPANY acting for and on behalf of Protected Cell No. \_\_\_\_ - \_\_\_\_

By: \_\_\_\_\_

Its \_\_\_\_\_

ATTEST:

By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

OAK HARBOR REINSURANCE COMPANY

By: \_\_\_\_\_

Its \_\_\_\_\_

ATTEST:

By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

OAK HARBOR REINSURANCE COMPANY  
Protected Cell Program Agreement for and with respect to  
Protected Cell No. \_\_\_-\_\_\_

**Schedule 1**  
**Management Fee and Administrative Fee**

**1. Management Fee**

The “**Management Fee**” shall be [2%] of the Insured Participant’s Gross Subject Premium with respect to that year and shall be due upon execution or renewal of the Agreement and may be collected by the Insurer on behalf of the Company.

**2. Administrative Fee**

The “**Administrative Fee**” shall be [1.25%] per annum of the average daily amount of Protected Cell Resources, excluding any Funding provided pursuant to Sections 4.2 and 4.3, calculated and due at the end of each calendar quarter on a Pro Rata basis. The Administrative Fee for the Protected Cell shall be subject to an annual minimum of \$25,000.

The average daily amount of Protected Cell Resources, excluding any Funding provided pursuant to Sections 4.2 and 4.3, is the sum of the closing daily balance of such amount during the calendar quarter divided by the number of business days in that calendar quarter.

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**Schedule 2**  
**Initial Funding**

The Initial Funding with respect to the Policy Year shall be [22.59%] of the initial estimated Gross Subject Premium. The initial funding is the minimum initial funding required.

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**Schedule 3**  
**Contingent Funding**

The Contingent Funding with respect to the Policy Year shall be the sum of the following:

1. [22.59%] of the difference between the initial estimated Gross Subject Premium and any subsequent estimates of Gross Subject Premium as determined by the Insurer; and
2. The Insured Participant's Pro Rata share of any Expenses or investment losses linked to the Protected Cell.

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Protected Cell Program Agreement for and with respect to  
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**Schedule 4**  
**PIP Distributions**

The Insured Participant's Pro Rata share of a distribution shall be determined as follows:

**Timing of Determination**

The Company will calculate the Amount Available for Distribution with respect to the Policy Year 18 months (the "**First Calculation**") and 27 months after inception of the Policy Year and every twelve (12) months thereafter.

Within 60 days of the First Calculation, the Board will determine whether to declare and pay a distribution, not to exceed 50% of the Amount Available for Distribution, and within 60 days of each subsequent calculation of the Amount Available for Distribution, the Board will determine whether to declare and pay a distribution.

**Amount Available for Distribution**

The "**Amount Available for Distribution**" for the Policy Year shall be: (u) the net premiums ceded by the Insurer and received by the Company for the Policy Year, *plus* (v) the Investment Income received for that Policy Year, *less* (w) the Losses for that Policy Year, *less* (x) the Expenses for that Policy Year, *less* (y) any other charges or amounts the Company in its sole discretion deems necessary or appropriate to meet the current or future obligations identified with or attributed to the Protected Cell and *less* (z) all previous distributions for that Policy Year.