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LEGAL DEPARTMENT



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August 9, 1994

Mr. Myron Mitsuyasu
Kamehameha Schools/
Bishop Estate
Legal Group
P.O. Box 3466
Honolulu, Hawaii 96801

Dear Myron:

Over the past few months, you have had several conversations with myself and various different people from our office regarding KSBE's formation of a captive insurance company.

Many of our earlier discussions were based on the captive insurance company proposal submitted to you by Marsh and McClennan (MM). After examining the proposal, we discussed that it did not appear that a captive insurance company would provide KSBE significant tax benefits or savings. If KSBE forms a captive insurance company, it should do so for non-tax business reasons. Recognizing this fact, you indicated that MM believes there are a number of non-tax reasons to form a captive, such as:

- A captive would provide more stability in the areas of worker's compensation, property, general liability and auto liability insurance since those particular insurance markets are unstable in Hawaii;
- The captive would be used as a long term planning objective;
- The captive would provide stability and predictability in cash flows and investment income;
- The captive could, in the future, provide pollution and environmental liability insurance;
- The captive would have direct access to the re-insurance market as a means of reducing costs.



A large portion of our discussions revolved around the implications a captive insurance subsidiary may have on the tax-exempt status of KSBE. We discussed that in order to preserve KSBE's tax-exempt status, it is important that the captive does not create a situation where a private individual receives a benefit from KSBE's involvement in the captive. Arm's-length relationships between KSBE and the captive would be absolutely necessary to prevent private inurement (benefits flowing to insiders such as trustees and directors) and/or private benefit (benefits flowing to third parties such as other subsidiaries) from becoming a problem. In this context, for example, premiums paid into the captive by all the entities involved would need to be actuarially appropriate in order to prevent the IRS from taking the position that KSBE is improperly subsidizing a for-profit subsidiary. While the IRS may take the position that this might result in private inurement, we do not agree.

It is necessary that the corporate governance (i.e. the board of directors and the corporate officers) be independent, in order to maintain the corporate separateness between KSBE and the captive subsidiary. It is important to keep the captive's business activities separate from the tax-exempt activities of KSBE, so as not to create a situation where the captive's activities could be collapsed into the activities of KSBE.

An independent board of directors would also show that KSBE does not control the captive. Some KSBE employees may be directors on the board. However, it is important to maintain a balance between outside independent board members and employee-board members. We would recommend that a majority of the directors be outsiders.

At your instruction, we did not have our insurance actuaries review the financial projections of the captive insurance project. Our comments are based on our discussions over the past few months with both KSBE and MM personnel and the text materials provided in the MM proposal.

Regards,

A handwritten signature in cursive script that reads "Mark".

Mark L. McConaghy