

# THE TEAM WITH THE BEST PLAYERS

WINS..... Jack Welch

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## Set Aside Money for A Rainy Day

By William York, VP of Marketing



My father always taught me to set aside money for rainy days. “You have to pay yourself first” he would remind me. “Before you spend any money that you earn, you have to pay yourself by saving some money for a rainy day”.

This was, and still is, great advice.

**Is the same advice true for businesses and business owners?**

Recent history has shown that most businesses were under prepared for the “rainy days” which were created as a result of the recent pandemic. Threats to business in 2021 and beyond will undoubtedly, have their own challenges as they struggle with the aftermath of these current events. We should assume that the future will be marked by economic, technological, political, regulatory, social and legal changes as we learn and prepare from these recent events. Simply put, business will face a far greater threat than they could have ever imagined.

**Today, it is not uncommon to read an article about a business crippled or closed down by these new world threats.**

In response, many business owners began choosing to save after-tax profits for future “rainy days” in addition to enhancing their commercial liability insurance coverage as a reaction to these issues. The thought was and is to fully protect their enterprises through whatever method makes sense. These “rainy day” funds being created are actually a method of **informally self-insuring. Therefore, the question becomes – is there a better way?**

As business owners reacted in this way, many began to understand that purchasing additional public commercial insurance to cover these risks actually represented a possible “**sunk cost**”. A sunk cost is defined as something where money is spent and may not be recovered? This solution could actually compound the problem as the short-term solution leads to a longer-term problem. After a year or two or three or ten or twenty with no insurance claims, a business could be left with nothing to show for the additional insurance premiums spent. A dilemma, a choice ..... “**rainy day coverage or rainy day funds**”? On the flip side, not incorporating additional insurance alongside the “rainy day” fund often results in businesses being under-insured for real risk that could cripple or close their business.

**A business owner recently remarked: “The global pandemic has wreaked havoc on my supply chains. The effects of the supply chain deterioration have led to product shortages and large percentage price increases. In order to employ workers that possess the values and the work ethics we require; we are imposing an**

**increase on all our prices. While we are able to absorb part of this, these higher costs represent the sharpest rate increase since May of 2011”.**

The positives of a “rainy day” fund are that it provides some risk management, gives a business financial flexibility and avoids the “sunk cost” of purchasing additional third-party commercial insurance. The negative of a “rainy day fund” is that it is usually funded with after-tax dollars and usually does not provide enough dollars for loss mitigation in the event of an adverse event.

The positives of purchasing additional third-party commercial insurance are that it provides far more financial recompense should a loss occur *and* it is funded with pre-tax dollars. The greatest negative of purchasing additional insurance coverage is that premiums are a sunk cost. Also, many standard insurance policies contain provisions, caveats and policy limits that can result in a loss that is only partially covered or not covered at all

It is possible however, to create a solution that eliminates the trade-offs outlined in the preceding paragraphs. A business owner can implement a third element into its risk management program utilizing a “Captive Insurance Company” used as the chassis to formally insure against “rain days”.

This is a more comprehensive approach in preparing for the possible “rainy days” a business could face.

This was the goal of a program instituted by the State of Connecticut in March of 2020, when they launched the “re-imagining business insurance” initiative. It is a three-pronged approach by which a business can assess, control, finance and monitor risk from all three of these approaches for the purpose of increasing the organization’s short and long-term value to its stakeholders. This approach worked and is continuing to work because it results in more risk insurance in place and more monies being created for future “rainy days”. A great part

of the “sunk cost” of regular commercial insurance was converted to a platform under the captive insurance component wherein the business retained all the surplus that was established under its captive insurance program. A business was now able to build a larger “rainy day” fund and increase its immediate protection.

As we think about the future of business, it is clear that optimizing the availability of having a “rainy day” fund also improves the “rainy day” coverage and is an ingenious method. It not only enhances and protects local businesses as shown in Connecticut, but it also helps to strengthen the economic base of the state because of the increase in taxation caused by the additional insurance put in place.

Once again it shows the resiliency of mankind. Working together, the state and local businesses were able to develop not only an immediate solution but a long-term solution that will in time become a standard for others in the United States.

“A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty”.

--- Winston Churchill ---

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