

THE TEAM WITH THE BEST PLAYERS

WINS..... Jack Welch

Newsletter June 1st, 2018
Volume 6, Issue 6

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Self-Insurance the Captive Way

By William York, VP of Marketing

A captive insurance company is one of the most powerful risk management instruments that a business can create. It can also be a powerful wealth accumulation tool. Properly structured there are very few financial vehicles that compare with a captive insurance company. When a business chooses to own its own insurance company they are able to:

- **improve risk management** – a captive allows the business to expand risk management and customize risk associated with the specific business needs.
- **close the gap** – a captive can close the gap in third party insurance coverage
- **asset protection** – a captive can improve asset protection for the business and business owner.
- **enhance wealth accumulation**

Formation of Captive Insurance Company – Simple Concept

1. **Increase Insurance Coverage -** The business increases its insurance coverage. This makes the assumption that the business owner is keeping existing third party coverage in place or replacing third party coverage with insurance through the captive with a reinsurance (or stop-loss) policy in place.
2. **Retain the Money –** The business owner is the owner of the Captive and owns the premiums paid to the captive insurance company. This assumes that the claims paid by the captive would have been paid from retained earnings

or operating profits in the absence of a captive.

3. **Nearly Double the Money –** The premiums paid to the captive are taxed at 0% if the captive makes an 831(b) tax election. This assumes that the captive receives premiums of \$2.3 million or less annually and a combined state and federal income tax rate of 40% or more.

What Exactly Is Self-Insurance?

Self-insurances are those losses which occur that are not covered by commercial insurance. The business must “pay the piper” so to speak. Most mid-sized businesses self-insure by use of retained earnings, operating profit or the business owner’s savings account. Sometimes even a bank loan. Even with strong third party insurance coverage in place, mid-sized businesses are still made to cover a wide variety of risks. ERM (**Enterprise Risk Management**) in business is the method and processes an organization uses to identify, manage and minimize risk. ERM is important because its success determines the health and life of the business enterprise. If an organization fails to identify risks to its existence, it will be ill prepared to face any of these risk events.

Very often businesses are not covered by third party insurance and this can exhaust the company’s retained earnings and drain the business owner’s savings. In some cases it can cause the business to close.

A Different Way – a Superior Way

A far more comprehensive and thorough risk management approach (ERM) is to combine third party insurance with a captive insurance company. The captive insurance company provides proper self-insurance for the business. Captive insurance combined with third party insurance forms an intertwining web of insurance coverage to the business. The captive insurance company can also accumulate additional reserves in those years where there are low claims. These reserves can provide more robust insurance

coverage in the future and, when necessary, can be accessed by the owner (or CFO) as a repository to address contingencies or unanticipated risks.

What exactly is a Captive Insurance Company?

Simply put, a captive insurance company is an insurance company. It is a C corporation that is licensed and domiciled the same as any commercial insurance company. Captives have their own reserves, policies, policyholders and claims. Insurance policies are issued by the captive to its parent or related companies and are actuarially priced. Captives are generally formed to insure the risks of a business, group of businesses and related or affiliated third parties. Owning a captive insurance company is a sophisticated way to self-insure and often form the backbone of an ERM program.

What If the Business Experiences a Loss?

When experiencing a loss that is not covered by commercial insurance policies, the business can file a claim when insured by policies issued by its captive. Captive policies are often broadly written with less exclusions than commercial policies. This helps to ensure that the business can get assistance when needed. One of the great features of captives is that they enable businesses to pay for this year's problems with prior year's taxes (or what would have been paid as taxes in prior years without the captive in place.)

What If the Business Experiences a Loss that is Not Insured by the Captive or By Commercial Insurance?

In most cases the business can take a dividend from its captive to address a loss or a revenue shortfall.

What are the Long-Term Benefits of Captive Ownership?

- 1) The captive can provide the network of coverage as described above for many years.
- 2) Assets in the captive are protected from creditors.
- 3) Reserves accumulate in the captive, particularly in years with low claims.
- 4) Captives receive favorable tax treatment which enables the owner's wealth to increase.

- 5) The captive is able to invest and grow a large pool of assets.
- 6) And, finally when the business owner is ready to sell or retire they own the captive and its wealth.

A successful captive will amass wealth for its owners. This wealth can be accessed and enjoyed in the future. A captive has the unique ability to improve risk management and at the same time aggregate wealth.

Please call me or e-mail me to discuss any questions you may have about risk management and captive insurance companies.

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