THE TEAM WITH THE BEST PLAYERS WINS……. Jack Welch

Newsletter September 1st, 2020
Volume 8, Issue 9

Independent Captive Associates, LLC, 6900 Jericho Turnpike, Syosset, NY 11791
www.independentcaptiveassociates E-mail address *promano@independentcaptiveassociates.com*
Offices located in Boca Raton, Florida; Richmond, North Carolina; Simsbury, Connecticut; Syosset, New York

ADDITIONAL THOUGHTS FROM LAST MONTH!

By William York, VP of Marketing

What do the overwhelming majority of Fortune 500 companies have in common?

They are in the insurance business!

They have created wholly owned insurance companies, privately owned insurance companies, referred to as "captives," to insure their risk.

It's kind of simple.

Fortune 500 companies have been in the insurance business for more than 60 years.

They understand the unique features of operating their own insurance company.

They understand that one of their largest business expenses can be controlled and turned into additional capital and profit!

They understand what Warren Buffet meant when he said that the insurance business is the best business in the world.

A "captive insurance company" is a closely held insurance company that does not write policies for the general public……..it is a private insurance company.

A Captive Insurance Company writes insurance for the company that owns it.

It receives a tax deduction on the insurance premiums it pays into the company that it owns.

It retains the underwriting profits on all monies not paid out in insurance claims. It invests and grows these monies into profits for the company(s) that own the private insurance company.

It provides transparency and flexibility on all the insurance coverage that it writes.

It pays claim and does not raise rates after an expected actuarial calculated event.

It eliminates the massive overhead built into commercial insurance companies …. salesmen commissions, large executive salaries, advertising expenses and other multiple layers of fixed costs.

It writes and insures risks that the business owners feel is difficult to obtain in traditional insurance markets, extremely expensive to obtain, or have low frequency of occurring. Coverages that they believe are manageable.

It operates as a separate business that pays its own operating expenses.

It files its own tax return.

It files an annual audited tax statement.

It pays appropriate taxes.

It has annual board of directors' meetings.

It is a real insurance company operating under the guidance of the state insurance department where it is domiciled.

ADDITIONAL THOUGHTS FROM LAST MONTH!

The term *insurance* is not defined by the U.S. Tax Code, but rather has been developed through court cases over many years. These court cases have determined that insurance must constitute three elements:

1. a binding insurance contract,
2. an irrevocable shifting of risk from the insured to the insurer.
3. a distribution of risks among a certain number of participants covered under the insurance company.

To distinguish a captive insurance company (which can feature deductible insurance payments by the operating business) from self-insurance (which does not), the court developed guidelines that each captive insurance must meet.

The premiums paid to a captive are deductible against federal income taxes, if the transaction qualifies as insurance under the three-prong test stated previously:

1. There must be a transfer of the risk of loss from the insured parent/affiliate to the captive in exchange for premiums paid.... **Risk shifting**.
2. The captive must sufficiently distribute this risk to the point where an actuary can reasonably price the premiums**.......Risk Distribution**
3. The business operation must be insurance in the commonly accepted sense.... claims, reserves, surplus, actuarial certainty etc.

Normally **captives** do not replace all existing commercial insurance programs. Captives are integrated with commercial insurance coverage to achieve greater efficiency for a sponsoring business. They help to control insurance costs while providing expanded coverage in a tax efficient manner.

A captive can insure against pandemics and other non-damage related business interruption events, such as loss of rental income, losses caused by government decrees, cyber risk, or most issues threatening a business that keeps a business owner up at night. Captives were able to mitigate much of the losses caused by Corvid 19. Other typical coverages offered by a captive include owner/firm legal defense expenses, deductibles for third-party insurance, trade losses, customer bankruptcy, cyber losses, tenant loss, supply chain interruption, regulatory fines and cyber theft.

On an annual basis, the premiums paid to the captive in excess of its claims and operating expenses can be made available for investment or distribution to shareholders.

The more captives grow (today they represent more than 50% of all business insurance coverage), the more information middle market businesses are learning. This is a quiet evolution that will hopefully assist companies moving into the **new normal** after the recent pandemic. Just imagine the new cyber risk of people working from their homes as we return to the **new normal** .... maybe you should begin to explore this alternative approach to risk management.

Call Independent Captive Associates, LLC sponsored by the National Network of Accountants, to learn how to get started.

Pamela Romano
Ph: 516-629-9045
Email:
promano@independentcaptiveassociates.com

Independent Captive Associates, LLC
6900 Jericho Turnpike, Suite 300
Syosset, NY 11791
www.independentcaptiveassociates.com