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CASE STUDY



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By Ronald M. Roth, Executive Vice President
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Client/Challenge: The owner of a successful hospitality company came to us for risk management and business planning. He had started this business from scratch. To date, the company had grown to sixteen locations that provided high-end catering for individual and corporate events across three states. In addition, his group owned luxury/boutique hotel properties and restaurants. His primary concerns were as follows:

The cost of his commercial insurance had increased significantly. Year after year he was paying rising premiums and over a 10-year period of time he had collected very little back in claims. He calculated that 91% of his premiums paid over that period of time had been retained by the commercial insurance companies, yet his rates were still rising. He had consulted with multiple commercial insurance brokers, yet due to market conditions, they were unable to offer any options that would adequately address the problem.

The COVID-19 pandemic caused hiring and retention of quality employees to become a significant challenge. He needed a plan to make, attract and maintain a high level of talent in his organization. This was especially important in this industry. The hospitality business is known for not taking care of its employees over the long term and the pandemic caused this to become even more noticeable.

Many of his customers had become concerned about having to cancel events due to unforeseen occurrences from the pandemic and other scheduling issues. They had been inquiring about event cancellation insurance. The coverage was available through commercial carriers, but the contract language and coverage were complicated.

Recommendations: We suggested that this client engage us to do a feasibility study that would ascertain the benefits of a *private captive insurance company* for his organization. Ultimately, this feasibility study indicated that the following benefits could be derived by implementing a captive insurance company in coordination with the client's commercial coverage:

1. By shifting a portion of the company's low frequency/low severity risks from the commercial carrier to the captive the client would lower their commercial insurance premiums and potentially *recapture* underwriting profits back into the captive. These profits would have otherwise been enjoyed by the commercial carrier. The premiums to the captive were paid with tax deductible funds as the captive was providing necessary insurance coverage to the underlying organization. Over time, these profits should build and create a "war chest" in the captive that could be used for a variety of important business planning purposes.

2. One of the uses of captive assets would be to create a plan to reward key employees who remain with the company over chosen periods of time. Such a plan could be structured to meet the individual needs of each selected employee and arranged without the limitations of ERISA based benefits plans. This would separate them from their competition as robust benefits programs are rare in the hospitality industry.

3. The captive could provide insurance to the underlying organization for them to offer *Event Cancellation Insurance* to their customers, as an option in their event contracts. An actuarial study was completed as to the proper premiums to charge based on the levels of coverage the customers would enjoy should they elect the option in their event contract. The revenue collected by the organization would be over and above their normal event rates and the transaction would be very efficient for the customer and profitable to the captive.

Outcome:

The client created a private captive insurance company. Based upon the feasibility and actuarial studies performed during the formation process of the captive, a number of commercial lines of risk were identified and deemed to be appropriate coverage for the captive. These lines were moved from the commercial insurance market to the captive insurance company upon licensing and creation of the captive insurance company. As soon as the first year, the client enjoyed underwriting profits in the captive. In year two, by carefully selecting the appropriate risks to begin the captive, the client was able to continue expanding the lines of risk being covered in the captive and at the same time reduce premiums being paid to commercial carriers and overall insurance costs in general.

In addition, the client is currently enjoying an 80% acceptance rate on their event cancellation insurance option. Customers are feeling more comfortable scheduling events and paying deposits knowing that if they should need to cancel their event due to an unforeseen cause of circumstance, they will not lose money. With almost 3,000 events already either conducted in or scheduled for 2022, the event

cancellation program has already become very profitable for the captive.

Finally, the captive insurance company was structured in such a manner that certain shares of stock can be awarded to key executives and employees in the future. This program will allow these employees to accumulate *non-voting stock* in the company that will vest over a number of years that they continue to work with the organization. As the business continues to grow and prosper, the value of their stock will continue to increase. This type of benefit is quite unusual in the hospitality industry. It shows ownership's desire to not only take the highest quality care of their customers but their employees as well.



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