

Captive Insurance for Small to Mid-Sized Businesses

September 13, 2022



Learning Objectives

Upon completion of this course, attendee will be able to:



- Understand methods of Risk Management, particularly Risk Transfer
- Describe characteristics of Insurance Companies, including Captives
- Identify businesses who qualify for and could benefit from a Captive Insurance Company

Jeremy Colombik, CPA, Managing Partner of MSI

Jeremy Colombik is an experienced, licensed financial professional. He is a graduate of Western Illinois University, having obtained a Bachelor of Business degree with a major in Finance. Jeremy is a licensed CPA and a member of the American Institute of Certified Public Accountants, and the North Carolina Association of Certified Public Accountants. Furthermore, he has been in the captive industry for over 15 years and is a member of the Captive Insurance Companies Association and the North Carolina Captive Insurance Association. He frequently works with the North Carolina Department of Insurance Commissioner as well as U.S. Congress and Senators in Washington D.C. on regulatory and compliance issues. In addition, he served as Former Chairman for the North Carolina Captive Insurance Association.



Jeremy is the President of Management Services International (MSI). MSI has managed hundreds of businesses that are utilizing a captive insurance company structure. MSI currently is one of the largest captive managers in the state of North Carolina. He has authored articles for Captive.com, Captive Review, Captive Insurance Times, Captive International and other publications. Jeremy is a sought-after speaker for professional groups, such as: CPAs, lawyers and financial advisors, on how a captive structure works and could be a great benefit to their clients.

Management Services International



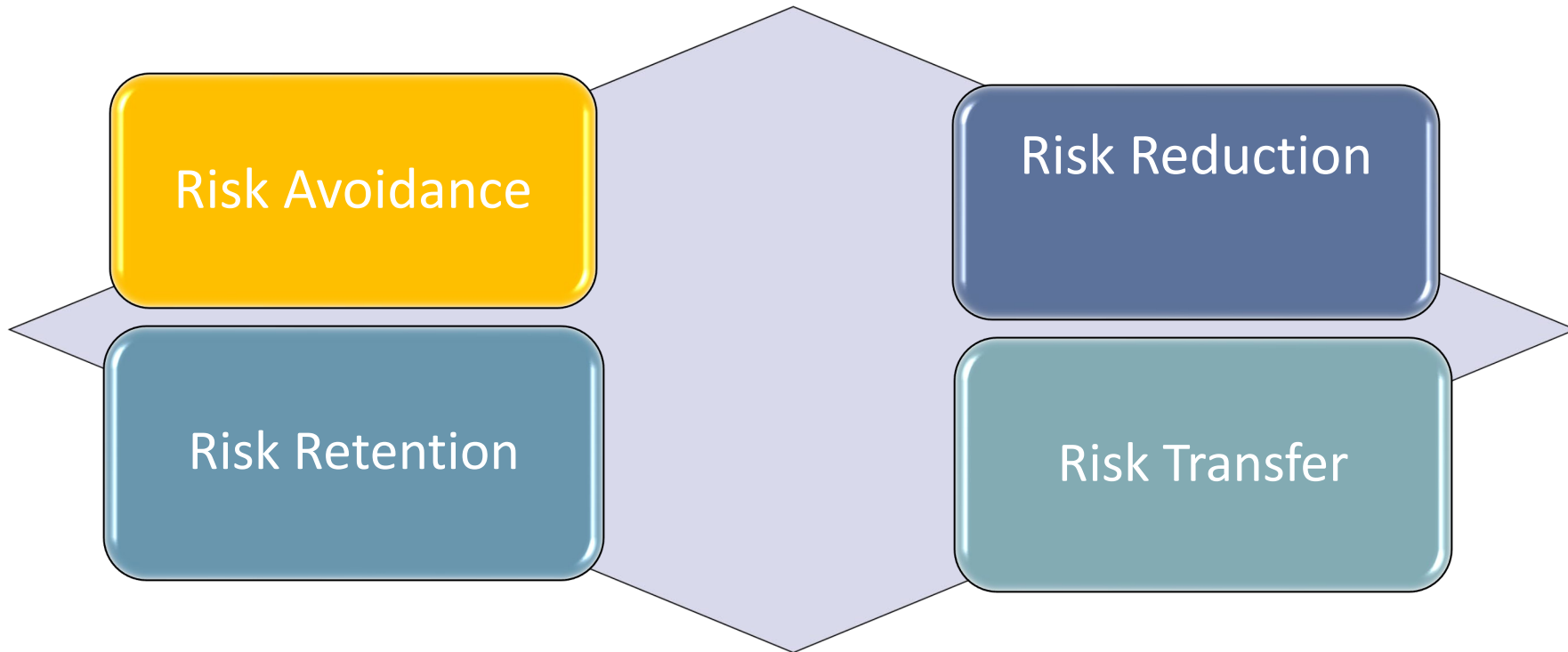
2019, 2020, 2021, 2022
US Captive Awards
Finalist

Who Are We?

- Award winning Captive Insurance Company Manager
- Provide Turn-Key Captive Insurance Company management for Business Owner(s) for more than 15 years
- Turn-Key Non-Qualified Deferred Comp, NQDC provider
- Proprietary NQDC structure for Business Owners
- www.themsicorp.com



Methods of Risk Management



What is a Captive Insurance Company

It is a Licensed Insurance Company

- Owned by a business owner
- Insures risk of Operating Business(s)
- Retains profit on insurance policies written



Specialized Insurance policies

- Insurance policies specifically tailored to needs and risks of individual business
 - Insure risk excluded by Commercial Insurance policies
 - Broader coverage, fewer exclusions - COVID 19 examples
 - Create policy when no other policies exist
 - Cover known and unknown business risk



From The CPA Journal 2018



- Currently, commercial insurance companies are not capable of reacting to the rapid changes of the modern marketplace, nor have they ever been capable of insuring the many hidden risks most businesses face.

Hurricane Sandy

During Hurricane Sandy, flooding damaged electrical equipment located in the basement of a commercial office building, causing a legal firm in the building to relocate uptown.

While the firm's *commercial insurance policy refused to insure* it for flood damage, its *captive insurance company covered this event.*

The CPA Journal 2018



Typical Captive Insurance Policies

Deductible Reimbursement

- General Liability
- Pollution Liability
- Products Liability
- Workers Compensation
- Other Policies

Contingent Business Income and Expense

- Business Interruption
- Supply Chain Interruption
- Contract Cancellation
- Regulatory Change
- Labor Shortage/Stoppage
- Loss of Professional License(s)
- Loss of Key Contract/Customer
- Loss of Key Person
- Uncollected Receivable
- Pandemic

Executive Risk Coverages

- Reputation Expense
- Legal Expense & Defense Costs
- Fiduciary Liability
- Wage and Hour Expense
- Injunction Relief
- Employment Practices Liability
- Employee Dishonesty
- Directors and Officers Liability

Other Coverages

- Cyber Risk
- Patent Infringement
- Pollution Liability/Clean Up
- Reputational Risk/Brand Rehabilitation
- Strike Insurance
- Subcontractor Assurance Coverage
- Voluntary Product Recall
- Contaminated Product Recall
- Environmental Liability/ Pollution

Gap Coverages

- Contractual Liability
- General Liability Gaps
- Intellectual Property
- More.....

Property

- Equipment Breakdown
- Property Damage - In Transit
- Property Damage - Mold & Fungi
- Crop Insurance



****Actuarial assessment
of additional risks
available***

Captive Insurance is Highly REGULATED

- Domicile, state or country
- Domicile regulates
- Many offshore re-domiciling to United States



Requirements of Insurance

- Risk Shift
- Risk Distribution
- Actuarial determined premiums
- Insurable Risk & Underwriting
- Issue policies
- Claims procedures
- Reserves



Insurance Company Reserves



- The funds that state insurance [regulators](#) require insurance companies to maintain at any given time
- The purpose of reserves is to help ensure that insurance companies have adequate money and liquidity to honor current, and future, claims of policyholders

IRS Exam Issues

Avrahami case Summary & Lessons Learned

- There were many areas in which the Avrahamis' captive was not acting like an insurance company.
- To receive the benefits of insurance company taxation, a captive must be an insurance company.
- The court held that captive was not an insurance company and did not qualify for income tax benefits or taxation that are accorded to an insurance company.
 - This case provides many guidelines for what to be aware of and how a proper insurance company should function. Unfortunately for the parties at issue, the captive failed almost every test and the results were, as one would anticipate, a large loss for the taxpayer.





Puglisi Egg Farms v. IRS Commissioner

- Puglisi sought a captive solution as the coverages they were seeking were not available in the commercial market
- The captive filed 5 claims
- Under reinsurance agreement, 20 percent of all approved claims of Puglisi Egg Farms were the clients (related), and its quota share of 80 percent of all proved claims of unrelated entities insured by the fronting company - (Risk Pool)

CIC Services v. IRS

- Notice 2016-66
- May 17, 2021 - CIC won in Supreme Court
- March 21, 2022 - the U.S. District Court for the Eastern District of Tennessee vacated notice 2016-66





Reserve Mechanical Appeal

- 5/13/22 Reserve lost their appeal in the 10th Circuit Court of Appeals
- Court ruled that Reserve Mechanical was not an Insurance Company

Reason: \$340,000 insurance claim paid without supporting documentation, gave the impression that there was no Claims Process in place

- Court noted that not all Risk Pools are bad

Captive Growth

- The growth of all captives continued, and by 1992, the number of reported captives had reached 3,150, with annual premiums paid exceeding \$11 billion. By 1998, 80% of Fortune 500 companies owned captives; by 2010, Swiss Re reported that captive insurance company premiums worldwide had reached \$60 billion annually.

The CPA Journal 2018



Captives Considered Mainstream

- 90 percent of Fortune 500 Companies have Captive
- More than 3 dozen states domicile Captives
- 1980, 1,000 Captives Worldwide
- Today, more than 6,000 Captives Worldwide



Types of Captives

According to the National Association of Insurance Commissioners, there are many types of captive insurance companies, review common types



- Single-Parent or Pure Captive
- Group Captive
- Association Captive
- Rent a Captive (Segregated Cell, Protected Cell)

What is an IRC 831b Micro Captive

- An 831(b) allows a small insurance company to receive up to \$2.45 million per year in premiums, without paying any income taxes on those premiums
- The 831(b) election does not affect -- at all -- the deductibility of the premiums paid by the operating business to the Captive. Premiums are otherwise tax deductible, that may be deducted by the operating business just like any premium payments to a Captive.

Qualifications for Captive Insurance

- Businesses with annual gross revenue of one million or more
- Business Owner(s) seeking better management of risk
- Business Owner seeking insurance that is not offered in the Commercial Insurance Market



Business before Captive

- Yearly Gross sales \$7,500,000
- Business Income of \$1,000,000

Risk Insured with Commercial Insurance Policies:

Work Comp, Property, General Liability and Professional Liability

Self-Insured Risks:

Directors & Officers, Reputation Expense, Regulatory Change, Employment Practices, Regulatory Investigation and Employee Dishonesty





Business Using Captive

Yearly Gross sales of \$7,500,000
Business Income of \$1,000,000

Captive Benefits:

- Profit Center
- Cover Risk Excluded from Other Policies
- Better Management of Risk
- Increase Risk Awareness
- Tax Benefits

	<i>Captive Solution</i>	<i>No Captive Solution</i>
Business Income	1,000,000	1,000,000
Captive Solution	(500,000)	
Remaining Business Income after Captive Solution	500,000	
Less Taxes	(210,000)	(420,000)
Profit center after expenses for Captive	452,500	
Total Dollars	742,500	580,000

Risk Insured with Commercial Insurance Policies:

Work Comp, Property, General and Professional Liability

Risk Insured with Captive Insurance Policies:

Directors & Officers, Reputation Expense, Regulatory Change, Employment Practices, Regulatory Investigation and Employee Dishonesty

Journal of Accountancy

November 2016

- Captives are powerful risk management tools, if operated correctly.





Captive Operations

- Feasibility Study aka Risk Assessment
 - Business forms Captive or becomes shareholder in Captive
- Captive offers insurance to Captive Owner or Captive Shareholder(s)
- The business applies for, and purchases, insurance from the Captive
- Actuary assesses risk and determines premiums
- Policies are approved and issued to the business

Captive Management

- Turn-Key Captive Manager
- Captive Manager has team





**Management Services
International LLC**

7000 Six Forks Road, Suite 104
Raleigh, NC 27615

For more information



John Dohn

National Sales Manager

John@themsicorp.com

847-254-3028