

'Capturing' insurance

How captive insurance companies can offer specialized coverage and savings **Interviewed by Kristen Hampshire**

One size does not fit all in the world of insurance coverage. The commercial market provides packaged programs that work for some companies, but there are limitations on the type of endorsements and changes you can make to those policies.

If you pay \$1.5 million to \$2 million or more in annual premiums and "pre-made" programs aren't meeting your business's insurance needs, it's time to consider starting a captive insurance company.

"If you want to get the specialized coverage you need for your business, it's better to set up your own insurance company than to find those coverages in the marketplace," says Larry Pevnick, CPA, member of the insurance and reinsurance services department at Brown Smith Wallace LLC.

A captive insurance company is essentially a mini-insurance business — a subsidiary corporation established to provide your organization with a tailored insurance program. There are many benefits to this arrangement, including potentially significant tax savings.

Smart Business spoke with Pevnick about captive insurance companies, how to start one and how they can save you money.

What are the hallmarks of captive insurance?

Because you are creating your own insurance program for your own company, you can design it to meet your specific needs. You have greater control over your program and coverage because you do not have to choose a cookie-cutter offering from the commercial marketplace. You also have more control over claims, and your employees are more likely to embrace safety programs and other initiatives at your business to reduce those claims. There is a larger incentive for cost and loss control. If you own the company, you are motivated to keep a clean loss record so premiums do not increase. Every dollar you don't have to pay toward premiums or claims goes back into your pocket. This is a powerful tool for businesses in all industries, given the right circumstances.

What companies are best suited for this?

Companies that have a lot of exposures benefit most. For example, a \$20 million



Larry Pevnick, CPA

Member, insurance and reinsurance services
Brown Smith Wallace LLC

manufacturing firm would have higher premiums than a \$20 million accounting firm. The first question to ask yourself is: Do we have a high level of exposures that we are currently not insuring? Or, is the cost of insuring those exposures out of control? A perfect example is a contractor who must pay an exorbitant amount for workers' compensation coverage. A captive insurance company can be put in place to control workers' comp costs. Then, the contractor can give employees safety incentives, which further controls costs. Savings compound over time. Insurance captives are especially attractive to closely held businesses that have an incentive to reduce costs and increase profit. Captives are a mechanism of protecting organizations from external exposures.

How does a captive help reduce costs and increase profit?

The IRS gives insurance companies a tax break that other businesses don't get. Insurance companies set aside reserves to pay for claims. They can deduct the value of those reserves before claims are paid. Most corporations can only take deductions after expenses are paid. If you own a captive, you

can use this tax deferral technique to build wealth. Also, captives are estate-planning tools if you, the owner, assign a family member as the president of your 'internal' insurance company. As wealth is generated through the captive by way of tax-deferral strategies and savings due to decreased exposures and lower premiums, that 'profit' can be protected while being transferred from one generation to the next.

What are the steps for starting a captive insurance company?

First, you should enlist a CPA or insurance broker who is experienced in captive insurance. It is particularly important to work with someone who understands the nuances involved with qualifying the captive as an insurance company for tax purposes. The professional will review the pros and cons of setting up a captive, and review your current coverage. This person will get to know your business inside and out, identifying risk exposures and areas where your insurance needs are not being met. The adviser will review the organizational structure of your company and learn how and where your business operates. Then, he or she will work with you to design a program. The whole process can take three to six months.

Why don't more closely held companies utilize captives?

There's a myth that you have to be a big, public company to start a captive insurance company, but this simply isn't the case. While candidates are generally in the \$25 million to \$100 million revenue bracket, any closely held company in any industry that pays \$2 million or more in premium costs per year should consider a captive. Another reason captives are not buzzed about more is because many CPAs and business advisers are unfamiliar with them and, therefore, do not recommend them to their clients. This is a highly specialized field, and starting a captive necessitates seeking out a professional who is well versed in how to design and manage a suitable program for your company. <<

LARRY PEVNICK, CPA, is a member in charge of the insurance and reinsurance industry group at Brown Smith Wallace LLC. Reach him at lpevnick@bswllc.com or (314) 983-1247.