Why Use a Captive Insurance Company to Mitigate Risk?

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BOCA RATON, FL, US, June 22, 2018 /EINPresswire.com/ -- A Captive Insurance Company (captive or CIC) is a property and casualty insurance company established to provide coverage primarily for a Parent Operating Company. Captives are an effective risk management strategy to insure against risk for which commercial insurance is not available or may be too expensive.

Examples of exposures often incorporated in captive insurance arrangements include enterprise risks such as business interruption resulting in loss of income due to: breach/release of data, deductible reimbursement, loss of licensure, legislative and regulatory changes, loss of franchise, reputational risk, supplier/supply chain interruption, etc.

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Many operating companies face losses from these low frequency/high liability risks, which can be better managed through coverage from a captive insurance company rather than self-insuring. A policy issued by the captive insurance company will have the features and coverage's drafted to meet the specific risks unique to your business.

A little background on what a captive is an insurance company is. Captive insurance companies are wholly-owned by one or more non-insurance companies to insure the risks of its owner (or owners). Captives are really a form of self-insurance whereby the insurer is owned wholly by the insured.

They are typically established to meet the risk-management needs of the owners or members. Captives are formed to cover a wide range of risks; practically every risk underwritten by a commercial insurer can be provided by a captive.

To begin, let us be clear that captives are all about money. You want one to make money. It will cost money to have one. You will pay your own losses, come what may.

Captives are another method by which risk of loss is financed. They are not inherently mysterious, or illegal, or a silver bullet for all situations and have been around for over 100 years. The fact that the insured, or an entity closely related to the insured, is the owner/operator is a separate and distinct fact, which may or may not intrude on the captive transaction.

A Captive can also be used to cover gaps in coverage for business enterprise risk or interruption. Here are just some of the actual net loss Insurance policy scheduled events that can be covered with a captive.
There are many, many other considerations and structures to a captive. It can reinsure traditional lines such as workers compensation, general liability, auto liability, professional liability, and credit risk.

This is due to the relative ease and certainty of projecting losses and revenues with coverage's in which claim payments occur years after the incident of loss, known as long-tail losses. More and more captives are entering property fields or short-tail losses. The traditional view of restricting captives to long-tail business has encountered the reality of escalating prices and lack of availability.

A captive can also be used to provide coverage and limits not available in the market, such as credit risk and terrorism. The captive can provide a tax-sheltered approach to large retention's. If no certificate is required, it can accept direct placements.

Captives are highly regulated and are required to operate as bona fide insurance companies. Therefore, acceptable uninsured risks must be present before a captive insurance company can be formed.
Once the captive is operational, with coverage's designed to fit the insurance needs of the business, the captive owner or “insured” may be eligible for captive insurance tax advantages (namely with captives formed under IRC 831(b).

For example, $1,000,000 in earned profits are subject to a tax margin of at least 45%, and in some states, over 50%. This means, by not using a captive, at least 45% (or $450,000) is taxable, leaving you with a retainer of $550,000.

With a captive, you can retain the full $1,000,000. The monies are kept in the captive to cover unexpected losses. And if those losses don’t come to fruition, you can retain these funds as investment income.
Captive insurance tax benefits under IRC 831(b) have been a proven strategy for improving cash flow for many mid-market businesses. It has allowed business owners in the middle market to play on a more level playing field with large insurers.

Ultimately, the financial benefits to captive and alternative risk planning promote growth, sustainability, and resilience.

With considerable effort, there are occasional personal tax advantages that can be obtained with a captive, but these require a sophisticated, knowledgeable consultant, and there are the usual caveats about taxing bodies.
Some captives have performed so well for their owners that they have re-domesticated to the United States, filed for licensing as an admitted insurer, and offered primary coverage, replacing their risk-sharing partner.

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