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CAPTIVE INSURANCE

An introductory guide to Captive Insurance

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WHAT IS CAPTIVE INSURANCE COMPANY?

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"The CIC was originally created to solve the problem of rising commercial insurance costs and the difficulty in obtaining certain types of insurance coverage. Most companies now establish CICs for miscellaneous reasons such as cost reduction, risk management, or risk control."

What is a Captive Insurance Company?

A Captive Insurance Company (CIC) is a property and casualty insurance company that is established to provide coverage primarily to a parent Operating Company. Captives are an effective risk management strategy to insure against risks for which commercial insurance is not available or may be too expensive.

A CIC formed by a business or business owner can provide flexibility in covering property, casualty, and liability risks and the potential to retain underwriting profits. Premiums paid to a captive may be tax deductible as a business expense, and premium income to the captive may be reduced by loss reserves or, for certain small captives, nontaxable up to a limit under Sec. 831(b).

CIC Coverage Examples:

- Data Breach / Release of Data
- Employment Practices Liability
- Loss of Key Employee
- Loss of Key Client
- Loss of Key Vendor
- Loss of Licensure/Certification
- Loss of Market
- Reputational Risk

Captive Insurance Benefits

It's clear why over 50% of the Fortune 1500 companies have captives.

Captive Insurance Companies provide risk mitigation, protection, and reduces exposure for the parent company. Additionally, it's an opportunity to create asset growth, building a non-correlated wealth accumulation account for captive owners over the long haul. Even without the tax advantages, the captive is an excellent business planning vehicle. Being able to insure low frequency, high risk events keeps your business secure.
CICs are an ideal solution by allowing premiums received to be invested rather than "lost." They may issue property and/or casualty insurance coverage against a wide variety of possible exposures. In addition, it enables owners to insure against commercially unavailable or unaffordable liabilities. Access to reinsurance markets and additional estate planning benefits are among many other ancillary benefits CICs provide their owners.

"ÅÎÅÆits Overview

- Improve Risk Management
  - Customize Policies
  - Increased Breadth of Coverage
  - Greater Control of Collecting on Claims
- Reduce Insurance Costs
  - Stabilize Pricing
  - Manage Deductibles
  - Retain Premium Dollars
- Increase Cash Flow
  - Earn Investment Income
  - Retain Underwriting Profits

Ideal Captive Insurance Candidates

A wide range of businesses can benefit from owning a captive insurance company.

What kind of businesses or business owners are the best candidates for CICs? Profitable businesses with uninsured risks, a history of low insured losses, and businesses willing to undertake the cost and management of the formation and administration of the captive.

Larger corporations can benefit from a wholly-owned captive, insuring a variety of risks. Smaller companies may find a Micro Captive fits their risk management needs. Conducting a Feasibility Study will allow a company to assess potential risks, analyze tax considerations, and determine if they are an ideal candidate for a Captive Insurance Company.

Types of Captive Insurance Companies

- Diversified Captives
- Micro Captives
- Special Purpose Captives
- Single Parent Captives
- Group Captives
- Association Captives
- Protected Cell Captives
- Rent-a-Captive
- Risk Retention Captives
- Industry Captives

7700 France Avenue S., Suite 430, Minneapolis, MN, 55435
PH 952-835-4295 F 952-835-0295 redhawkwa.com
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Capture Structuring

- **Micro-Captives 831(b)**
  - Under Section 831(b) of the Internal Revenue code, insurance companies that write $2.2 million or less in annual premium only pay income tax on investment income. This means that underwriting surplus and profits can accumulate in the insurance company on a tax-deferred basis. Risk is shared and distributed according to safe harbor and IRS guidelines.

- **Property & Casualty or Pure Captives 831(b)**
  - A Property & Casualty Captive Insurance Company, or Pure Captive, writing less than $2.2 million, insures more traditional E&O, Health, Workman's Comp and exposures.

How to Set up and Manage a CIC

Setting up and managing a Captive Insurance Company may seem like a daunting task; CICs can be very complicated and are heavily regulated. It's very important that you hire a captive manager to serve as the administrator of your CIC.

Put Redhawk Wealth Advisors' years of experience to work. We make managing CICs less complicated and more understandable.

Steps to Set up a CIC

- Feasibility Study
- Determine the Risks
- Obtain Third Party Administrator
- Domicile Selection
- Submission of application for an insurance license

Managing Administrator

- Appropriate Investment Plan
- Risk Distribution
- Checks and Balances
- Process Claims
- Navigate Industry Guidelines

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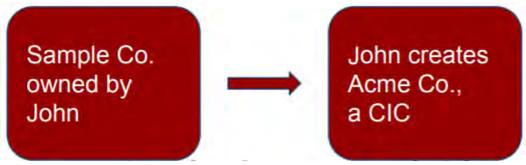
Captive Insurance Company Example

Sample Company, owned by John Anderson, has uninsured risks that his current third-party property and casualty insurance company doesn't cover. John creates Acme Co., a Captive corporation, an insurance company covering Sample Company's uninsured risks.



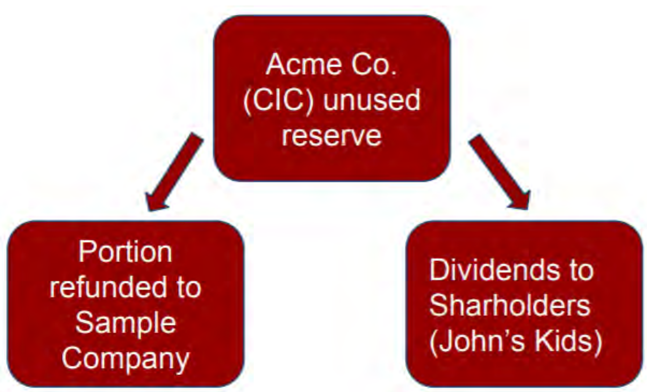
The insurance premium for the uninsured risks are determined to be $1,200,000 per year. Sample Company pays the $1,200,000 premium to John's Captive Insurance Corporation, Acme Co. Under the Captive rules, all of the $1,200,000 is income tax free to Acme.

Acme Co. has the entire $1,200,000 to invest (minus fees). However, Acme Co. is a Captive and must hold the premium, plus earnings, as a fund to pay claims for the risks it insures.

Sample Company pays premiums to the Captive to insure for litigation defense, professional liability and contract fulfillment. Remember with a commercial insurance company, if the insured has no losses, the CIC keeps the entire premium.

Even though a Captive cannot reduce premiums, a financial windfall results if the insured's actual losses are less than actuarially predicted.

For example, suppose John's Captive, Acme Co, has an unused reserve. A portion of the unused reserve can be refunded to Sample Company, reduce future premiums or be paid to the Captive's shareholders (John's children) as a dividend.



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Next Steps

- **Watch our Captive Insurance Company Webinar with Rich Ericson, President, ALink Captive Insurance Services**
  - Watch Here
- **Schedule a Complimentary Call to Learn more about Captive Insurance Companies**
  - Schedule Here
- **Learn more about Redhawk and how we help Advisors throughout the country**
  - Learn More Here
- **Read Redhawk's other Red Papers**
  - Read Here

For more information, please contact Redhawk at either research@redhawkwa.com or (952) 835-4295.