



WHY CREATE A CAPTIVE?

Most business owners do not know what a Captive Insurance Company is, and many of those who do know about them may not be comfortable using one. In simple terms, a Captive Insurance Company (“Captive”) is an insurance company formed and operated by the principals of a business to insure the business. Why would a business create a Captive? Initially, we need to answer a more fundamental question.

First, why do businesses purchase any insurance, ever? It may seem like a silly question, but it goes to the fundamental reason that Captives exist. A business has risk exposure, i.e., it may suffer a loss itself such as fire or water damage, or it may get sued by a third party. When this happens, the business suffers a greater loss if it is not insured, and thus it makes sense to pay for insurance coverage. This is simply good risk management, and most people see the advantages of being insured. Insurance is not cheap, however, and premiums are driven up when claims are made, whether the claim is a “first-party” claim, or by a “third-party” who sues the business. Unfortunately, one of the reasons that insurance is expensive is because some people in society are careless and damage property and/or injure people through their carelessness. This drives up the insurance rates not only for the careless person, but for everyone else *including a careful business*. This leads us to the next question, why should a business pay inflated insurance prices if that business is itself careful and safe? Captives help solve that problem.¹

A Captive provides an inexpensive way to manage a business’ risk, thereby allowing the principals of the business to enjoy a greater profit while at the same time having the safety net of good insurance coverage. In essence, a business who purchases insurance from a Captive, which the business principals own, is able to keep the profit that an outside commercial insurance would enjoy from a careful business. In addition to enjoying the insurance profits, the business is allowed to deduct the insurance premiums from the business revenue for tax purposes.²

Second, are Captives real, or are they a scam to steal a business’ money? Captives are authorized under Internal Revenue Code section 831(a) and 831(b) and have existed for decades. They are definitely real, and not a scam. Indeed, the principals of the business own the Captive and are in control of its accounts.

¹ We must note that if the business is careless and does not strive to minimize its risks of loss, then a Captive is probably not right for that business. Business owners who do not care to minimize their losses by having a reasonable standard of care should probably just continue purchasing expensive commercial insurance.

² Ask to see our video explaining the risk-management cost savings Captives offer.

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A Captive is also regulated by its domicile's department of insurance. A Captive is a proper insurance company that involves risk-shifting, risk-distribution, takes on the insurance risk, and meets commonly accepted notions of insurance. It is created for legitimate nontax reasons to face actual and insurable risks, and the premiums are determined by actuaries under commonly accepted actuarial principals.

Will a Captive provide me with good insurance coverage? Yes, most definitely. An actuary will determine the premiums based on proper actuarial principals for coverage that is appropriate for your business' risk. For example, your business may already have commercial insurance with a policy limit of \$5 million. You can purchase the same policy limit from a Captive, which will use a portion of the premium to purchase reinsurance in the wholesale market, which is much cheaper than the "retail" insurance cost, as you would have now avoided the middleman with their high premium prices and extremely limited coverages.

Why do I need INXS Captive Management LLC? You don't. A business can create its own Captive and manage it without a management service. The whole purpose of creating a Captive, however, is to effectively manage the business' risk inexpensively. So, you should know that a business that creates and manages a Captive without a management service is taking a huge risk, because if the business and the Captive do not follow the rules, the Captive will not be recognized as a legitimate insurer and the business and the Captive will likely be exposed to incredibly significant tax liability.

I'm interested, so what do I do now? We would like to help you manage your risk in a more cost-effective way with enhanced insurance coverage. Please contact us to discuss if a Captive is right for you and what the next steps are involved.