

CASE STUDY



Forming an Insurance Captive
Saves Residential Real Estate
Company Over \$200,000 in
Insurance Fees

Challenge

A residential real estate company needed help determining whether forming a captive insurance company would alleviate an unexpected rate-on-line increase.

Solution

Armanino's tax and insurance experts helped the company restructure what it was paying in the commercial marketplace. They increased the company's deductibles and insured the resulting gap in coverage into a captive. Armanino also ensured that the captive was properly set up to qualify for captive insurance tax benefits.

Result

By forming a captive, the company saved over \$200,000 in insurance fees in just one year and anticipates saving at least \$1 million over a 5-year period.

Client Challenge

A residential real estate company that owned more than 50 different multi-family residential real estate facilities saw a sharp increase in its 2020 insurance renewal rate.

This rate hike was unexpected as the company had a solid claims history. The organization maintained good safety records, vetted their tenants well, and ensured that their facilities were safe and issue-free. Yet, when they received their renewal estimate (a figure based on X number of dollars per valuation and referred to as the rate-on-line (ROL)), they noticed the ROL for some of their facilities increased by as much as 70%.

This ROL increase was due to two factors: a hardening insurance market (i.e., positive financial results were becoming more difficult for insurers to maintain as well as dwindling capacity in the marketplace) and a growing reluctance by commercial insurance markets to have coverage in residential real estate.

The company approached Armanino for solutions. They were aware that similar pain points were being felt across industries and knew that some organizations were turning to a captive insurance strategy. They wanted to get more information on captives and determine whether forming one was the right choice for them.

Our Solution

Armanino – a top 20 CPA and consulting firm with experts uniquely qualified to navigate tax and insurance complexities – recommended that the real estate company restructure its insurance purchasing and overall risk management program and form a captive insurance company. A captive serves as a formalized version of self-insurance, providing coverage to its owners and related parties. The captive insurer can cover the parent company and any subsidiaries. This arrangement could give the company the flexibility to control costs and services, reduce premium volatility and better manage risk in a hardened insurance market.

Our experts started by helping the real estate company restructure what they were insuring in the commercial marketplace. They took the company's current deductibles – approximately \$25,000 – and increased them to approximately \$250,000. Our experts then helped structure the captive to insure the resulting gap in coverage. This saved the company a significant amount of money in the short term, and if they keep the captive in place long-term, they should ultimately be able to build a surplus in the captive.

WHAT THEY'RE SAYING

“Armanino’s insurance and tax experts came up with a truly innovative idea to help us to address a significant, real-world problem. This solution will not only save us dollars in our insurance spend but also provide us a substantial return on our investment.

Chief Financial Officer

Armanino also helped the company ensure that the captive was structured properly. This step is crucial because, if the captive is not properly set up, the premiums paid to the captive are not tax deductible.

In order for the premiums paid to the captive to be tax deductible, the captive must qualify as an insurance company for federal income tax purposes. Courts have formulated a four-factor test to analyze these situations, in which the company must demonstrate that:

- 1) They are insuring an insurance risk
- 2) The required regulatory formalities of an insurance company are being observed
- 3) Risks are properly being shifted to the captive
- 4) The risks being insured by the captive are appropriately distributed

Armanino analyzed the client’s circumstances and helped structure the entity and insurance policies so they aligned with the four-factor criteria. As a result, the company was able to qualify and derive captive insurance tax benefits and cement themselves as having a valid captive insurance arrangement.

The Result

In its first year, the company’s move to a captive yielded over \$200,000 saved in insurance fees and what is estimated to be at least \$1 million in surplus over a 5-year period, with the possibility of significantly larger surpluses if claims are as anticipated. But there were also intangible improvements realized. The client was able to customize their insurance coverage, take greater control of risks and costs, and directly profit from the cost and risk strategies they implemented. According to the company’s chief financial officer, “Armanino’s insurance and tax experts came up with a truly innovative idea to help us to address a significant, real-world problem. This solution will not only save us dollars in our insurance spend but also provide us a substantial return on our investment.”

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