EXECUTIVE SUMMARY

STRATEGIC RISK ALTERNATIVES

ENTERPRISE RISK MANAGEMENT

In today's ever changing risk environment, it's important for successful businesses to develop a comprehensive Enterprise Risk Management (ERM) program. An effective ERM program not only addresses tangible asset risk through traditional insurance carriers but also addresses intangible asset risks.

Tangible assets are a business' physical assets (building, equipment, etc.) while intangible assets are a business' non-physical assets (e.g. brand reputation, blue sky, cash flow, etc.). As mentioned above, tangible assets can be covered by traditional insurance carriers through commercial insurance policies, workers comp, etc. Intangible assets are either underinsured by traditional carriers or uninsurable. Despite business owners placing more value in their business' intangible assets, owners fail to address risks associated with those assets.

Enterprise Risk Management has been utilized by Fortune 500 companies since the '90's and have in large part leveraged certain tax incentives to mitigate risks to their intangible assets.

Tax incentives are a tool that congress uses to guide economic behavior. Within the 1986 Tax Reform Act, congress created a tax incentive for business owners to address some of the risks business owners were already self-insuring with after tax money. To encourage business owners to manage risk more efficiently, congress included the 831(b) section of tax code in the 1986 Tax Reform Act.

Section 831(b) of the U.S. Tax Code provides a tax incentive to own a small property and casualty insurance company. Under 831(b) the first $2.2Million of premium ceded to the insurance company is non-taxable. By utilizing the tax incentive created by the 831(b) tax code, business owners can effectively

EXECUTIVE SUMMARY

create a tax-deferred “rainy day fund” for themselves to mitigate risks that may affect their business’ future health.

Like most laws that congress passes, the 831(b) tax code has been interpreted and refined by the executive and judicial branches. The original code was broad, for example: within the tax code an “insurance company” was not explicitly defined. But, after thirty years of its existence, our firm believes the parameters have been set for businesses utilizing the 831(b) tax code. For simplicity our firm describes these parameters as a 3-part test to be defined as an insurance company: Part 1 – there must be a transfer of risk from the producing company to the insurance

company; Part 2 – risk must be distributed, you cannot own 100% of your own risk; Part 3 – the risk must be fortuitous in nature and not a business risk.

Our firm, Strategic Risk Alternatives, ensures that our clients comply with the 3 part test described above. Strategic Risk Alternatives (SRA) is the manager and administrator of the insurance companies.

Our firm is of the opinion that owning a small property and casualty insurance company will soon be a normal business practice. Fortune 500 companies have been utilizing the 831(b) section of the tax code for many years now and are primarily to thank for pioneering this concept. Until recently utilizing the 831(b) tax code was a costly endeavor, but with lower barriers to entry and competition driving costs down, small to middle market companies can now utilize this concept.

All businesses owners have to take an active role in their risk management, the world moves fast today. By owning an insurance company owners not only manage risk more effectively, but also create long term planning opportunities. We work with our clients’ other trusted advisors to make sure the decision to own an insurance company is truly in their best interests. For a more in-depth understanding, of utilizing the tax incentive congress has provided within the 831b tax code, we encourage you to do your own due diligence and set an appointment with our firm for further explanation of the process and the risks involved with owning your own insurance company.