



STRATEGIC RISK ALTERNATIVES

ENTERPRISE RISK MANAGEMENT ADDRESSING UNAUTHORIZED ACCESS RISK



With the consistent year over year growth of data breaches, it's important for successful businesses to develop a comprehensive Enterprise Risk Management (ERM) program that provides the capital and tools needed to mitigate the enormous cost of a breach. An effective ERM program can mitigate your data breach risk, address gaps in cyber insurance policies, and create a rainy day fund of tax-advantaged dollars to use in the event of a breach.

An effective ERM program should be considered at all levels of business, from Fortune 500 to middle market to family owned companies. Small to mid-size companies are targeted in 62% of all cyber-attacks. Many small to mid-sized companies cannot afford the security measures required to effectively prevent data breaches and encrypt data; making them prime targets for attacks.

The ability to mitigate these risks is imperative to the survival of even the most successful companies; the average cost to clean up after a breach in 2016 was \$690,000, and for middle market companies the average cost was over \$1 million. The total costs of a breach are not limited to money expenses, but also the intangible assets of a company may suffer from diminishing of its brand and customer goodwill. The total costs of a breach result in 60% of small companies going out of business within six months of a breach, and growing to 72% within two years.

Traditional insurance companies have begun to address these risks, but many of the policies available to purchase come with exclusions and specific sub-limits to protect the insurance company's exposure. It's important for a business owner to know what the policy excludes and the limits of liability it has. A standard policy excludes unencrypted data accessed through a breach, but less than 4% of data breach incidents involve encrypted data. Sub-limits

may also exist for consumer notification costs, regulatory investigations, and business interruption.

To address risks like those stemming from data breach, Strategic Risk Alternatives (SRA) is of the opinion that owning a small property and casualty insurance company will soon be a normal business practice. By utilizing the 831(b) tax code, business owners can effectively create a tax-advantaged “rainy day fund” for themselves to mitigate risks such as data breach. 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. Section 831(b) of the U.S. Tax Code provides a tax incentive to own a small property and casualty insurance company. In order to file under 831(b) code, the premium is limited to the first \$2.3 Million ceded to the insurance company and is non-taxable with an adjusting inflation rider. 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.

The original 831(b) code was broad, but after thirty years of its existence, SRA believes the parameters have been set for businesses to properly utilize the 831(b) tax code. For simplicity our firm describes these parameters as a 4-part test: 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 an ordinary business risk; Part 4 – The company must act accordingly within the principles of insurance. Strategic Risk Alternatives is an insurance administrator and its primary role is to ensure that its clients comply with the 4-part test described above.

All businesses owners have to take an active role in their risk management, the world moves fast. 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 of owning your own insurance company.

[1] All statistics referenced herein come from the Ponemon Institute’s independent research report:

“2016 Cost of Data Breach Study: Global Analysis sponsored by IBM”