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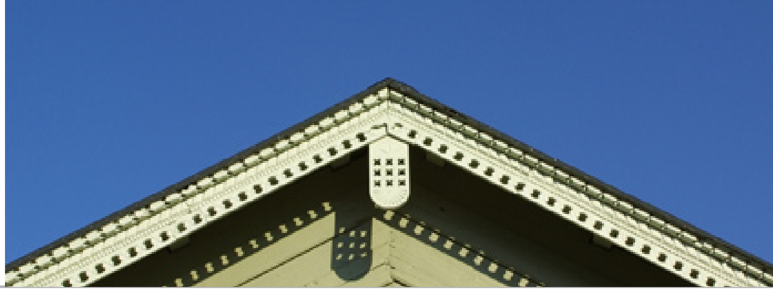

DIMENSIONS

Fall 2012

WEIGHING THE PROS AND CONS:
Should You Form a Captive Insurance Company?

Who hasn't written a check for an insurance premium and wondered, "Isn't there a better — or at least less expensive — way to insure against risk?"

For some contractors, that "better way" could involve forming a captive insurance company. Such a company can recapture the profits that are currently going to your insurance carrier, and also let you customize coverage to meet your needs.

That's the theory — and for some contractors, forming a captive insurance company is a wise move. As with many things in the contracting business, though, it's not always as simple as it seems. Here are some factors to consider.

Understanding the Basics

A captive insurance company is a legally licensed, limited-purpose property and casualty insurance company formed to insure the risks of its owners. Contractors typically form captives to provide coverage against a variety of risks, including professional liability, errors and omissions, general and umbrella liability, and workers' compensation reimbursement, to name just a few.

Unlike self-insurance or a simple "rainy day" fund, a captive insurance company must comply with specific risk-shifting, risk-distribution and reserve requirements that all licensed insurers must meet. A captive must spread its risk exposure adequately across various categories of risk.

Some large contractors achieve this broad risk exposure by insuring third parties such as independent contractors or other affiliated businesses, or by underwriting employee benefits programs. For most contractors, however, a better way to spread the risk is through association captives. These are formed by members of an industry or trade association to share the risks of the group.

In another type of group ownership structure known as "pool captives," a group of unrelated entities each form their own wholly owned captive insurance company. To provide adequate risk distribution, the captives then purchase reinsurance policies from the other captives within the pool.

Why Form a Captive?

One chief reason for forming a captive is to improve and coordinate risk management. For example, many contractors use a captive insurance company to insure against risks their commercial policies exclude.

Another approach is to purchase high-deductible (and hence, lower cost) coverage from a commercial insurer, and then use a captive insurance company to provide so-called "first dollar" coverage for losses below the deductible. Conversely, you could use a captive to add coverage above the maximum limits of a commercial policy.

Forming a captive also provides direct access to major reinsurance providers who underwrite the captive's risk, thus avoiding a commercial carrier's commission. A captive insurance company also makes it possible to accelerate tax deductions for losses.

A captive insurance company must be managed, operated and regulated as a legitimate insurance company.

For example, IRS revenue rulings require that captives charge arms-length premiums as established by customary rating formulas.

Also, individual states impose minimum capitalization and reserve requirements. Many captives are domiciled overseas, where these requirements are less stringent but, even then, you should expect to post either cash or a sizable letter of credit to build up adequate reserves against

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losses in the initial years. This commitment is in addition to the premiums paid.

Unless you have access to extensive credit lines, this letter of credit could restrict your borrowing capacity. The reserve requirements could also have unintended effects on your bonding capacity, since the capital you commit to a captive causes your balance sheet to appear weaker to the surety.

The decision to form a captive insurance company is complex, with many tax and financial considerations. This makes guidance from your financial, tax and legal professionals absolutely critical.

Under the right circumstances, the long-term payback of a captive insurance company can be sizable. Once the initial five to seven years of large reserve contributions are over, the captive can begin returning dividends to the owners, who can use them to reduce their overall insurance costs.

Please call us at 314.862.2070 for an in-depth evaluation of this or any other financial planning issue.

A GRACEFUL EXIT:
Managing the Details of Your Business Transition

This is the third in a series of articles on successfully transferring ownership of your contracting business.

It's often said that getting into the construction business is a lot easier than getting out. Transferring the management of an established contracting company to new owners can present many unexpected challenges, even if you are passing the company along to family members or other trusted insiders.

A successful transition requires a well-developed exit plan that allows you to leave the business on your own terms. Here are four critical components of such a plan.

1) The Exit Strategy Team

Creating an exit strategy team is similar to setting up a construction project — you must decide which facets of the transition project you will handle in-house and which you will assign to sub-contractors. Then select the subcontractors and other professionals to assist you.

Your exit planning team should work in a coordinated manner to ensure that your personal and business goals are addressed. It should include professionals you trust with expertise in various disciplines, such as transaction planning, personal and corporate legal issues, tax and estate planning, insurance and asset management.

Identify one team member to act as a "general contractor" for the project. This advisor will oversee all aspects of the transition plan, incorporating input from the other advisors to deliver a comprehensive exit strategy.

2) Capital and Financial Concerns

A construction business has unique capital needs. Banks and surety companies require a healthy amount of cash and other liquid assets, but such liquidity requirements may conflict with your transition planning goals — especially if you plan to sell the business to insiders and are depending on cash flow from the company after you exit.

Work with your advisors to determine how much liquidity must be retained in the business to supply the necessary working capital and keep the bank and bonding company happy. Recognize the key financial ratios they consider and determine how much flexibility you might have.

Then share your exit plan with your bank and bonding company. Explain your transition goals and get them to sign off on your plan well in advance. This will reduce the chances of last-minute surprises that could derail your plans.

3) Succession Planning Issues

Who is the right person to take over management of the business when you leave? Is it an existing employee? A family member? An outsider?

Begin grooming your successor well before your planned exit so you can feel confident that the business will be left in good hands. This is necessary not only for the sake of your customers and your reputation, but also to maximize the value of the business and minimize the risk associated with any future payments you are to receive.

One strategy is to develop a mentoring program. Offer your successor opportunities to prove him or herself by making independent decisions and finding his or her personal leadership style.

4) Maintaining Continuity

Also prepare other key employees for the transition. Your business will be at risk if your best project managers, estimators and foremen aren't on board.

Incentive programs can help motivate these key employees to remain active and involved in the company's management throughout the transition period. Deferred compensation plans, in particular, can give key employees financial incentives for staying with the company for a period of time after you leave.

Successfully exiting a business involves more than merely handling a financial transaction. By working carefully with a team of people you trust, you can develop an exit plan that helps you attain your goals, leaves the business in good hands, and leaves you satisfied with the decisions you've made.

Call us today for more information on transition issues.

HOLD ON TO TOP TALENT

Cost-Effective Employee Benefits

To hold down overhead and remain cost-competitive, many contractors are taking a fresh look at their employee benefits packages. Healthcare benefits are getting special scrutiny, but others are also under review — disability insurance, dental and vision plans, long-term care insurance, and 401(k) and other retirement plans to name a few.

Do you have room to trim benefits? Or would further cuts risk losing the key employees you need to operate successfully? Here are six steps that can help you find the right balance.

Begin by benchmarking. Study local or industry surveys to see how your benefits package compares with other contractors in the area. Trade groups and local business organizations can provide benchmarking data.

Talk to your insurance broker and other providers. Be frank and open with benefits providers: State your expectations clearly. If you need to hold the line on the costs your company incurs, let your broker know your limits.

Reassess employee contribution levels. Many employers have cut back on 401(k) matches, increased employee deductibles and co-pays on health insurance, and decreased or eliminated company contributions to family health insurance premiums. However, such changes amount to a direct hit on your employees' wallets, so you might want to consider other cost-saving ideas first.

Increase your bargaining power. Trade associations, chambers of commerce and other small business organizations can provide access to group rates for health, disability and life insurance. This may net you lower premiums than you could negotiate on your own.

Think outside the box. Not every employee benefit has to be expensive. Group discount programs can help your employees save on a variety of purchases, from amusements and travel to cell phones and other technology, while warehouse clubs offer savings on many everyday purchases as well. Such memberships are relatively inexpensive, but they can help offset reductions in other benefits and let employees know they are still valued. Other inexpensive perks include extra time off or fun activities like company picnics and parties. Again, check to see what other contractors are doing.

Consider deferred compensation plans. Sometimes called "golden handcuffs," these are nonqualified plans that offer key employees financial incentives for staying with your company for a period of time (e.g., five years). Unlike 401(k)s or qualified plans, they are not subject to ERISA restrictions and do not need to be held in trust. While the initial cash outlay is minimal, your company does not receive a tax deduction until you actually pay the promised benefit at some point in the future.

Often, the value of deferred compensation plans is tied to some measure of the company's operations. For example, phantom stock plans mimic actual stock performance but do not dilute ownership.

Even in an uncertain economy, the competition for the best employees remains strong. This makes now a good time to take a fresh look at your employee benefits — and make sure they will help you hold on to your top talent while holding down costs so you can remain competitive.

Let us help you review your incentive plans. Call us at 314.862.2070 today to schedule a consultation.

Getting Ready for an OSHA Visit

If an inspector from the Occupational Safety and Health Administration arrived today, would you be prepared?

The best preparation for an OSHA visit is to maintain a safe job site, which depends on effective and constant safety training. Here are some other key measures you should take to prepare for an OSHA visit:

Get organized. Assign one individual — ideally, your safety director or possibly a site foreman or other manager — to act as the company's spokesperson during an inspection. Assign another employee to document the visit by taking notes and photos of anything the OSHA inspector records.

Be proactive. Bring along several workers with tool belts. That way, if the inspector finds problems, they can be fixed immediately.

Get your papers ready. Be sure your records are complete and current and keep them close at hand. Among the important documents you should have ready are copies of your safety program, or an Injury and Illness Prevention Plan. You should also have Material Safety Data Sheets for every chemical or compound on the site, and a copy of your OSHA Form 300A for current and previous years. Though not required, records of safety training, internal inspections and safety committee meetings can be helpful.

Train for the inspection. An OSHA inspector may interview workers privately, so make sure all employees know how to respond. They should answer questions directly and honestly, but should give only facts — not opinions.

Finally, if your company cannot afford a designated safety director, you might consider outsourcing your safety program. OSHA offers classes on mitigating the dangers of construction work and provides a consultation service independent of its enforcement wing.

Call us at 314.862.2070 if you'd like to discuss OSHA preparation in more detail.

For more information, please contact **Tony Smith, CPA, CIT** or **Teri Samples, CPA** at 314.862.2070 or tsmith@muellerprost.com or tsamples@muellerprost.com.