Downey & Company, LLP

"**A CPA firm that understands dealership management, accounting, and tax issues**"

Maximize Profits with Dealer Owned Reinsurance Companies

We recently reviewed the financial statement of one of our client's reinsurance company. The results are quite impressive. The reinsurance company, which has been in existence for five years, has accumulated over two million dollars in cash and investments. In five years, the company has generated $3,200,000 in income with only $1,200,000 in claims and expenses. We anticipate that the future investment income may be sufficient to cover all of the claims on an annual basis, leading to a tremendous build up in cash and investments. This particular client has a properly organized "off shore" reinsurance company.

Many dealers do not form their own reinsurance companies because they are not familiar with the benefits or are fearful of the risk. Other dealers form reinsurance companies controlled by manufacturers or large insurance companies. Generally, these types of reinsurance companies do not maximize the profit potential and are inflexible. These programs have certain negative characteristics, as outlined below.

- The reinsurance company has additional risk since you are pooled with other dealers.
- Administrative fees charged to the reinsurance company are high.
- The manufacturer or insurance company selects the investment vehicles.
- Premiums are not deposited into the reinsurance company on a timely basis.
- The stock in the reinsurance company must be owned by one individual, limiting estate tax planning opportunities.
- Dividend payments are made at the discretion of the manufacturer or insurance company.
- The dealer has no flexibility in determining which F & I products to offer.

Some of the qualities of well organized dealer owned reinsurance companies are as follows.

- The company is never pooled with other dealers.
- Administration charges are approximately $125 per service contract.
- The dealer selects the investment vehicles, including cash, stock and bond portfolios, loans, mortgages, floor planning, and investment in floor plan offset accounts.
- Premiums are deposited in the reinsurance company within one week of remittance.
- There are no restrictions on the stock ownership, providing significant estate planning opportunities. In certain situations, key employees are offered stock participation.
- The company is formed in the British West Indies, where capitalization requirements are low.
- The Company takes advantage of the Small Casualty Insurance Company favorable income tax status. Companies with annual premiums of less than $350,000 are tax exempt; companies with premiums between $350,000 and $1,200,000 are taxed only on investment income; and larger companies are subject to C corporation tax rates after allowing for deductions for claim reserves.

- Claims are administered by a nationally recognized claims administrator.
- Detailed financial statements and performance results are monitored on a quarterly basis.
- The company has no employees and administration is similar to factory sponsored programs.
- The typical products sold are new and used vehicle service contracts, life and disability credit insurance, certified used vehicle plans and anti-theft and chemical systems.
- The management company will design the product, set up the corporation, administer the claims, provide accounting services and prepare your tax return. Most importantly, the management company will send in professional F & I consultants on a weekly or monthly basis to train and monitor your programs.

The following are examples of a premium allocation and a five-year projection for a medium size General Motors dealership based on a conservative penetration of products sold.

EXAMPLE OF A PREMIUM ALLOCATION:

Total Premiums on New Extended Warranty Contract	*$ 1,200.00*
Commission to Dealership	*(550.00)*
Dealership Remittance	*650.00*
Less Administration Fee and Other Fees (to Management Company)	*(125.00)*
Net Premium to Reinsurance Company	*$ 525.00*

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EXAMPLE OF **FIVE YEAR** PROJECTION USING 7% INVESTMENT INCOME

1,800 new extended warranties – 60% loss ratio	*$ 710,000*
1,200 used extended warranties – 60% loss ratio	*315,000*
1,800 certified used vehicle plan - 50% loss ratio	*100,000*
2,280 anti theft and etching systems – 10% loss ratio	*105,000*
1,800 chemical systems – 5% loss ratio	*65,000*
Credit life commission – 19% loss ratio, and accident and health commissions – 30% loss ratio	*390,000*
Total Profit Projection	*$ 1,685,000*

If your dealership does not have a reinsurance company, or if your reinsurance company is not performing to its potential, please contact please contact Paul McGovern at pmcgovern@downeycocpa.com or call 800.849.6022.

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