The Dealer Owned Warranty Company

By Mike Scolamiero, HARBORFIRST

The F&I department has evolved over the years and should now be one of the most successful profit centers in any dealership. The F&I industry, since its early beginnings in the Midwest forty-plus years ago, has continued to change each and every year. Although much of this change has been in response to laws being passed that aim to regulate an industry that Washington often fails to understand, there has also been a lot of growth in product offerings that brings value to customers and profits to dealerships. One thing that has remained a constant, however, are administrators continually trying to find new ways to attract dealers to their client base. The Dealer-Owned Warranty Company (DOWC) is becoming one of their biggest tools yet in that strategy, and one that is putting larger profits and greater assets into dealers' hands.

When this industry first began, profitable margins on product sales were considered found money. Dealers were happy with any amount that added to their PVR (per vehicle retail). In the 1980s though, administrators began floating the term "retro" around. With a retro, dealers were not only earning their store-level margins on their F&I product sales, but they now had an opportunity to participate in the unearned premiums. Administrators, in what some thought unthinkable at the time, were offering to share their profits with dealers in an effort to compete.

Then, in the 1990s, some administrators took it one step further by offering to not only share in the unearned premiums, but to also allow dealers to participate in the investment income that was being generated while products were earning out. Administrators began setting up offshore reinsurance companies for dealers, reserves began ceding into them, and dealers sat back and watched their profits accumulate. There are four main components enabling administrators to profit when partnering with a dealer, and with reinsurance companies dealers now had half of the pie.

The DOWC has actually existed for quite a while. The majority of dealers are either unfamiliar with it or have never been given a proper introduction. The reason for this is simple. Most administrators are not willing to offer it. For one thing, it can be a more difficult structure to administer, but, more importantly, their earnings potential is much less. With a DOWC, the administrator hands over three of the four pieces of the pie, leaving them with only the "admin fee". So, what exactly is a DOWC?

A DOWC is simply a U.S. domiciled "C" corporation, which acts as the obligor on vehicle service contract products. It is completely independent of the dealer's other business, meaning that their dealership's entity will never have any obligations in relation to their DOWC. Lenders actually require an insurance company to stand behind the DOWC and fulfill its financial obligations should it be unwilling or unable to do so. This is known as a CLIP, or contractual liability insurance policy. The DOWC is designed to maximize the amount of profits generated from the sale of F&I products. One of the components used to accomplish this is that third piece of the pie that the administrator is handing over to the dealer: net operating losses.

Anyone that tuned into the 2016 Presidential Election might be familiar with net operating losses, or NOL's. Donald Trump was scrutinized over what many claimed was misuse of them, and which have continuously helped him avoid paying millions of dollars in taxes.

In the service contract industry though, a DOWC takes advantage of the I.R.S.'s intended use of NOLs. When accounting, a DOWC recognizes expenses faster than revenue in its first few years, creating a build-up of NOLs. Due to the IRS tax treatment of "insurance-like" companies with long-term risk exposure, a prolonged tax deferral period (typically 8–10 years) is created where zero taxes are paid at the corporate level. Meaning, the DOWC can accrue investment income for years without having to pay taxes on it while it waits for its exposure to be fully realized. This presents the DOWC an incredible opportunity to generate additional profits over all other structures.

Below is a list of other benefits dealers often receive when participating in a DOWC in comparison to reinsurance and retros:

- Dramatically better investment income
- Better tax treatment on distributed funds
- Ability to borrow from the unearned reserves
- No premium or excise tax (2% -5% savings per VSC before ceding)
- No corporate tax on investment income for 8-10 years
- 100% reserve requirement (102% -120% in reinsurance)
- No Trust or Trust fees
- No shared risk

The benefits of a DOWC, when compared to a dealer's particular retro or reinsurance program, should be discussed with his or her personal CPA or financial advisor.

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