

A CHANCE TO SHINE

Ben Whitehouse of Butler Snow explains that in light of the COVID-19 pandemic many companies will likely be taking a second hard look at captives

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A chance to shine

Ben Whitehouse of Butler Snow explains that in light of the COVID-19 pandemic many companies will likely be taking a second hard look at captives

If traditional insurance doesn't cover a pandemic such as COVID-19, what options are available to businesses?

Any company affected by the COVID-19 outbreak needs to look at all of their current lines of coverage to see what may be applicable. In addition to the general liability and property lines, this could also include any environmental or pollution coverage, as well as even directors and officers coverage. Even if there is a specific policy exclusion for pandemics, some pandemic-related losses may be partially covered under other policies.

Many policies have a clause limiting business interruption coverage for when there has been a direct physical loss to a building. Whether this pandemic has caused such a loss is going to get a lot of attention in the courts. Businesses that are being forced to close to curve the COVID-19 outbreak may face difficulty

getting their claim timely paid while these coverage questions are resolved.

Businesses should expect insurance to cost more next year, especially if the market does not quickly recover most of its losses. Coverage will certainly be available, it just may come at a higher price, a higher deductible, and/or additional coverage exclusions. Insurers are likely going to raise rates to try and recover from the paid losses and extensive litigation costs as well as the shrinkage of their investment portfolios.

I would advise executives to contact their legal departments to find out what policies can cover, as COVID-19 could follow the same steps at the 1918-19 Spanish Flu epidemic, where there was a second influx of the pandemic.

We hear a lot of talk about 'flattening the curve.' Even when this first wave subsides, there are likely to be repeat

breakouts as travel restrictions ease. Businesses need to be prepared for not only resuming operations in upcoming weeks and months but the possibility for additional rounds of social distancing over the next year or longer.

Do you think there will be an increase in interest around captives because of the COVID-19 outbreak?

Many companies likely will be taking a second hard look at captives. The immediate issue will be marshalling the capital needed to put a programme in place. Once we get out of the fog of the current crisis; risk managers and chief financial officers should be discussing it. Traditional commercial insurance policies do a great job of managing risks that are reasonably well known and understood. They don't work nearly as well as covering new and emerging risks. When they try, the policies are generally full of coverage

exclusions or they are expensive, or both. Since business owners can design captive policies to meet their needs, they offer a tremendous amount of flexibility that no traditional policy could ever economically offer.

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It is this kind of environment where a captive insurance company can be given a chance to shine. A captive not only gives businesses the chance to recapture unused premium, but it also allows for more flexible policy forms without the fine print exclusions that lead to coverage gaps.

Do you see more companies moving to captive solutions, rather than traditional insurance?

Captives are always going to be just one piece of a business owner’s insurance portfolio. There are many risks at certain coverage rates that it makes far more sense to buy a commercial policy than try to put it inside a captive. Traditional insurance brokers keep their clients by keeping them satisfied and meeting their needs.

There are fairly common business interruption-type policies being written by hundreds of captives today that many businesses will have wished they had implemented five years ago. An insurance broker who wants to keep his or her clients satisfied should be looking at those programmes and making some introductions.

What advice would you give someone who is looking to start up a new captive?

While it may not be as easy to start one in 2020 as it was in 2019 or 2018, it absolutely can still be a viable option. Be realistic about your capital commitments and starting small with a plan to grow available coverage over the next three to five years is always prudent.

Although a captive might seem like a solution for pandemic coverage, what challenges do you think companies will face setting up a new captive at this current time?

In the immediate future, businesses are going to be careful about how they deploy their capital. Getting a business to make the full commitment to forming a captive and adopting new risk management strategies to support it will be even more challenging if we are truly heading into a recession. A business

who tries to set up a new captive with the hopes that they can ‘beat the market’ by merely replacing their existing policies with a captive programme that charges a lower premium usually end up being disappointed. Committing to a captive means understanding that the performance in year one or two does not necessarily indicate future success or failure. A good captive programme takes three to five years to fully develop and build up reserves.

I am certain that we will eventually see new insurance products to specifically address pandemic type coverage. I wouldn’t expect to see them until this current pandemic subsides. I would expect them to be expensive and full of exclusions that limit their scope. The message those of us need to better explain to the business community is that just like COVID-19 didn’t fit neatly inside of a box of currently offered traditional insurance policies, the next calamity to strike may not fit either. Captives provide the type of insured-driven flexibility to protect entrepreneurs that cannot be matched by the traditional market. Instead of just offering coverage for the last catastrophe, a captive can help actually insure businesses for the next one.

What trends do you expect to see in the captive space in the coming months?

I think you are going to see a lot of interest in deductible buy down captives. Renewal quotes are going to be higher and businesses are going to be looking at ways to manage their expenses. Taking higher deductibles on traditional insurance policies and putting more of that deductible layer inside a captive programme is a good strategy at any time. A broker or a risk manager may want to suggest forming or modifying their current captive to take on additional risk to defray these expected higher costs. ■