Reprinted with Permission

Post-COVID-19, Some Businesses May Look to Captives for BI Solutions, Observers Say

May 6, 2020 12:19:00 Eastern Daylight Time

WASHINGTON - In a post-pandemic world, disgruntled businesses may look to risk-mitigation alternatives like captive insurance companies, according to some captive market observers.

David Provost

One of the points of contention between business owners and commercial insurers has been business interruption coverage due to the COVID-19 shutdown. Most businesses discovered their BI policy did not cover pandemics, and many have filed lawsuits and lobbied legislative bodies to pass laws retroactively forcing insurers to cover it.

Existing BI policies provided actuarially accurate premiums, according to David Provost, deputy commissioner, Vermont Department of Financial Regulation. Business interruption coverage is typically triggered by events causing direct physical loss or damage.

“Typically, captives step in where the traditional insurance market has failed,” Provost said. “This has been trending for years, but this is going to be one more thing again that’s going to make this (a business owner say) — I wish I had a captive last year.”

“Now your eyes have been opened,” Provost said. “The market didn’t do what you expected it to do, so now you go take control with your own insurance company.”

Captive insurance will not necessarily provide a speeding magic bullet for businesses, said John Andre, managing director, AM Best Rating Services.

“It is very difficult to say that captive insurers will just immediately respond with a BI solution,” Andre said.

“There may likely be a measured response bespoke to each captive based on the individual risks associated with their businesses,” Andre said. “Some may have been studying the issue already, as previous events have brought BI and contingent BI to the forefront.”

Jason Palmer, director of Willis Towers Watson’s global captive practice, said they have already seen some changes in the market.

“Coverage for pandemic risk will be a very common coverage insured by captive insurance vehicles in the future; in fact many of our clients are already considering such coverage,” Palmer said. “I’m not convinced this will create a plethora of new captive formations solely for pandemic risk, unless there becomes a product that captives can access risk transfer.”

Creating a captive is more complicated than emailing a query to a traditional commercial insurance broker, asking for rates.

“In the wake of the pandemic all business should re-evaluate their risk strategies and captives should be one of the many alternatives considered, as insurance programs are restricted to meet the risks of this new ‘normal,’” Palmer said.

Under a captive insurance arrangement, a business owner forms an insurance company to fund losses, using their own risk capital rather than paying to use the capital of commercial insurers. Risk is covered through a formal insurance policy, which includes actuarially adjusted premiums for anticipated losses. It is different from self-insurance, which typically uses after-tax funds to cover losses.

Captives can be appealing when insurance in the commercial market becomes excessively expensive, Dan Towle, president, Captive Insurance Companies Association, said.

“The hard market was already upon us when this pandemic hit, which means that interest in forming captives was already strong,” Towle said. “From what we continue to hear, interest in captives remains strong and is a necessary investment in a long-term risk management solution.”

While most BI in the traditional market excludes pandemic coverage, “captive insurance may be the only way that businesses can customize a policy that includes pandemic,” Towle said.

The pandemic has revealed holes in the world’s preparedness safety net, said John C. Thomson, a former captive regulator from Connecticut. “No one wanted to look at it. We want everything to be predictable and guaranteed,” Thomson said. “Now organizations will look at risk differently and corporate structures need to look at their risk differently.”

The pandemic has changed how risk is gauged, Thomson said.

“We got to the collective mindset that we want everything to be predictable, very deterministic,” Thomson said. “We now operate with a much lower degree of predictability and live in an environment of uncertainty.

“Captives provide a perfect platform for corporate entities to start to look to structure, finance and manage risks more broadly — both known and emerging and unknown. With that you can structure financing,” Thomson said.

The post-coronavirus world will be an ideal time to look for alternative risk financing options, said Dominic Wheatley, chief executive of Guernsey Finance.

“As the market tightens, the ability to gain direct access to wholesale markets for capacity, and control the design of your own coverage, will optimize the coverage and financing of risk across the range of assets, operations, and associated liabilities faced,” he said in a blog posting.

Industry capital backing U.S. insurers and reinsurers writing BI could decline by as much as 50% on an after-tax basis if legislated policy changes force carriers to pay for two months of retroactive coverage on COVID-19-related BI claims, according to new Best’s Commentary (Best’s News Service, May 5, 2020). AM Best said it believes forcing insurers to pay for COVID-19-related business interruption claims, despite any specific policy exclusions, could threaten many insurers’ solvency and reap disastrous consequences for the U.S. property/casualty insurance industry.

To view AM Best analysis and commentary on the COVID-19 outbreak visit: http://www.ambest.com/about/coronavirus.html.

(By Frank Klimko, Washington correspondent, BestWeek: Frank.Klimko@ambest.com)

BN-NJ-5-6-2020 1219 ET #

http://news.ambest.com/newscontent.aspx?altsrc=108&refnum=225077