captive insurance times

Act now!

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-An interview with Randy Sadler

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As many businesses suffered from losses due to the COVID19 pandemic, industry experts suggest that now is the time to re-examine and explore your options.

While it would be a useful tool, no one is able to predict the unexpected, so having a good insurance policy in place to cover unforeseen events is critical. However, as organisations strive to navigate global risks, many were unprepared for the events that played out in early 2020. Although many companies set aside reserves to ensure their financial position during volatile market conditions, the duration and severity of this latest pandemic seems to have surpassed most businesses expectations and depleted reserves either dramatically or completely, according to Adam Miholic, senior consultant, global captive solutions at Hylant.

To compound an already unfortunate situation, Miholic says that even when companies felt they were protected by some insurance product such as business interruption or other first-party protections, most insurers were either quick to decline coverage or slow to respond with any position of certainty.

"The US federal government has taken steps to help mitigate the damage and put in safeguards for future similar events, but it is yet to be seen if this is too little too late for many businesses," he notes.

Many businesses found themselves in hot water since 51 per cent of organisations across the world do not have a business continuity plan, according to a study based on Mercer's Business Responses to the COVID-19 Outbreak Survey. Meanwhile, only 29 per cent of organisations' board of directors discuss risk exposures as part of their strategic plans.

Coverage with a captive

Unforeseen events including a global pandemic, the Texas power outage or even the most recent disaster with the cargo ship, Ever Given, blocking the Suez Canal and inhibiting trade, are unpredictable, complex and evolving risks.

Events such as these have certainly highlighted the benefits of captives with owners being able to design customised insurance coverage, access alternative capital, and generate profits through third-party business makes captives especially valuable during market transitions.

Randy Sadler, principal, CIC Services, explains that it is often "difficult and inefficient" for third-party commercial insurers to write customised policies.

"This reality often renders customisable coverage unaffordable or impossible to acquire," Sadler says.

In addition to a captive insurance company being used to mitigate risk, he suggests that there are ancillary rewards including the taxation of insurance companies makes captives an ideal vehicle for accumulating loss reserves.

As a licensed insurance company, a captive can also allow a business to gain access to reinsurance and excess insurance markets.

Re-examine and explore your options

So has there been an increase in the number of businesses exploring the captive option to cover unforeseen events such as the pandemic? Marsh's 2020 Captive Landscape Report, published in September, revealed that more organisations are considering a captive for insurance protection and financial flexibility in response to an increasingly difficult risk and insurance landscape.

It showed that the trend of increased captive use continued in the first half of 2020 amid an increase in challenging insurance market conditions and the impact of the global COVID-19 pandemic. Supply chain, business interruption and contingent business interruption premiums written saw an increase of 283 per cent on average in 2019, it also found. The COVID-19 pandemic has created an opportunity for captive owners to evaluate existing policies and companies to re-examine their insurance programmes to identify gaps in coverage. As the insurance market hardens further as a result of the pandemic, Sherman Taylor, executive director,

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Ocorian, explains: "The wisdom of having a captive as a risk management tool to supplement the insurance programme has become much more evident."

When looking at either an existing policy or exploring the captive option, Sadler suggests that companies need to take into consideration various factors.

The first is to take into account that business interruption often isn't enough. Sadler notes that in some cases, the nature of the pandemic insulates companies from paying business interruption (revenue replacement) claims to businesses. This was also an unfortunate issue as businesses in the US experienced civil unrest and riots that prevented access to their businesses.

"Many business interruption commercial insurance policies are tied to a property policy and only triggered if property is actually damaged— not when it's inaccessible," he adds.

The second is to have a business continuity plan in place. While some business continuity plans can be complex and lengthy, Sadler says the critical point is to establish a risk management strategy that will address the impact of unforeseen events, a decrease in revenue, cash flow and liquidity. Although it's late in the game to develop one now to address the pandemic, he emphasises that now is the time to start planning for the next crisis. The third is to make insurance with customised policy language. Most business owners or management teams would agree they could have benefited from more insurance with policy language customised for their business.

Sadler comments: "The pandemic brought to light not only risks that were uninsured or underinsured, but also risks that a business owner thought one had coverage for, only to find out that policy language excluded such coverage."

The fourth is to have a more sustainable cash flow and liquidity. If executive teams could have seen the future looking at 2020 and 2021, most would say they would have liked to have not only more customised insurance but sustainable cash flow and liquidity.

During COVID, Sadler explains that many businesses that lacked cash flow and liquidity opened credit lines found themselves struggling for survival.

He says: "Government programmes such as SBA funding and the Paycheck Protection Plan (PPP) helped, but it still led to 800 small businesses closing each day, according to a report by Yelp between April and September 2020."

The final takeaway, according to Sadler, is to consider a captive insurance company.

He says: "A captive insurance company can ensure that a business has sufficient insurance and sufficient liquidity to weather a crisis."

Crystal ball

Nobody has a crystal ball. As Miholic states: "It is difficult to properly fund for an event that has very little to almost no historical data to rely on."

However, he suggests that it is important to speak with your captive manager and service pro-viders to evaluate the most efficient way to begin financing for future unforeseen events now. The benefits of pre-funding for future events through the regulated entity of a captive insurance com-pany can be felt immediately upon the impact of a catastrophic loss.

"One of the most immediate and shortterm solutions could be to evaluate a difference in conditions policy through the captive that would respond in the event a specific policy either intentionally exclude a cause of loss or uses ambiguous language that leaves risk transfer coverage in question," Miholic explains.

He adds: "Any proposed new coverage or business plan change should be properly reviewed by the captive service providers and quantified with a qualified actuarial analysis."

Singing from the same hymn sheet, Taylor says: "It is difficult to predict when, where and how the next major disturbance will arise and so the best defence from a risk financing perspective, is to have a sound insurance programme which can accommodate a captive."

About the Interviewee

RANDY SADLER started his career in risk management as an officer in the U.S. Army, where he was responsible for the training and safety of hundreds of soldiers and over 150 wheeled and tracked vehicles. He graduated from the U.S. Military Academy at West Point with a Bachelor of Science degree in International and Strategic History with a focus on U.S. – Chinese Relations in the 20th century. He has been a Principal with CIC Services, LLC for 7 years and consults directly with business owners, CEOs and CFOs in the formation of captive insurance programs for their respective businesses.

CIC Services, LLC manages over 100 captives.

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