



ENTERPRISE RISK CAPTIVES: MADE FOR A TIME LIKE THIS

Rob Walling of Pinnacle provides his views on the current pandemic and how enterprise risk captives can rise to the challenge throughout this period

As the Old Testament Book of Esther story builds to its climax, the heroine Queen Esther faces a critical, risky decision in dangerous times. Her uncle, Mordecai, sends her a message: "Who knows? Maybe you were made queen for such a time as this."

The Covid-19 pandemic is presenting an existential threat to many businesses – reductions to top-line revenue, reduced bottom-line net income, and the potential for a longer-term recession. As I think about the economic impacts of Covid-19, I find myself repeatedly asking myself this question: "Were enterprise risk captives (ERCs) made for moments such as this?"

Let's start with the big picture.

Ultimately, all insurance policies are risk management tools. An enterprise risk captive is based on a specific risk management tool known as enterprise risk management or ERM. ERM is an ongoing process by which "an organisation in any industry assesses, controls, exploits, finances and monitors risks from all sources for the purpose of increasing the organisation's short- and long-term value to its stakeholders." (Actuarial Standard of Practice No. 46, Risk Evaluation in Enterprise Risk Management)

One way ERM increases value is to identify risks outside of the control of the insured that present material financial threat to the organisation. Once risks are identified, ERM looks for ways to mitigate or finance them. Most captive managers specialising in ERCs have rigorous risk assessment processes that identify risks that appear to present significant threats.



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Insurance coverages are then developed to address these risks. Many ERCs provide one or more policies that may provide coverage to insureds related to the pandemic.

Business interruption coverage

Business interruption or business income insurance (collectively BI) are coverages that are quite common in ERCs. While many BI coverages for admitted carriers contain specific epidemic exclusions, some captive versions of these coverages may result in claims for insureds related to the pandemic. BI insurance is commonly available in the commercial insurance market for loss of income related to property insurance claims, such as covered fire or wind events, as well as non-epidemic crisis events, and event cancellations. Coverage including coverage for epidemics is sometimes available, but far less common.

ERCs often use similar damage estimates to commercial BI coverage forms but vary the applicable cause of loss and exclusions.

The following coverages are all variations on BI coverage that differ, mainly, by varying the cause of loss:

- Supply chain – interruption caused by a disruption at a key supplier
- Contingent business income – interruption caused by a disruption of a non-related business, e.g. a neighbouring business or other business the insured relies upon
- Loss of key customer – interruption related to a disruption at a key customer
- Loss of key employee – interruption related to the death, disability or voluntary departure of a key employee, e.g. partner in a law or medical practice, a key manager or producer
- Inventory spoilage – interruption related to unusable inventory, e.g. restaurants, pharmaceuticals
- Loss of franchise – interruption related to losing a franchise, e.g. auto dealership/restaurant
- Trade credit/accounts receivable – interruption associated with excessive amounts of uncollectible receivables

Regulatory changes and administrative actions are additional coverages that may have applicability during this current pandemic. Given the sheer number of ways that federal and state authorities are impacting businesses – including forcing them to cease operating for a period of time



– such liability coverages may see claims activity. Related BI coverage designed for ordinance and law events may see claims activity too.

Claims possibility

Other common ERC coverages may also experience claims activity because of Covid-19. Companies who make the news in the wrong way may have brand rehabilitation or reputational risk claims. We have certainly seen several businesses receive bad press for their actions in the last several weeks. Coverages related to international exposures and political risk could also result in claims. Companies forced to use remote working arrangements may also be exposed to additional cyber liability risk. Medical stop-loss claims activity is likely to increase for businesses directly impacted by the virus due to infected covered lives. On the other hand, postponements in non-Covid-19 medical care may cause a lull in the current year, followed by a surge.

There are numerous situations related to traditional commercial insurance coverages that also may result in ERC claims activity. It is common, for example, for an ERC to provide deductible reimbursement, excess limits and differences in conditions (DIC) coverage that wrap around and complement existing commercial insurance

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policies. Under present circumstances, a variety of commercial coverages may have claims activity that consequently result in claims activity in ERCs. An excellent example are employment practices liability claims for a business that asked employees to stay on-site when they could have worked more safely remotely. Similarly, medical professional liability insurance may have claims for nursing homes and hospitals impacted by the pandemic. And what about products liability exposure if infected products are delivered to your customers?

Another way many ERCs may be ben-

eficial to their owners is through dividends. Many ERCs that have been in existence for several years have accumulated retained earnings on their balance sheets. Subject to state regulatory approval, ERCs may use some portion of these funds to provide dividends or distributions to their parent company that would allow the insured business to meet payroll and other expenses during a period of reduced income. It is also important to recognise that the amounts of retained earnings that may be available for dividends will necessarily be impacted by the captive's ability to pay claims and current claims activity, including Covid-related claims on both a direct basis and net of all reinsurance.

Summary

In conclusion, ERCs were built on the comprehensive risk assessment foundation of ERM. Many of the coverages commonly written by ERCs would appear to have broad applicability and claims potential due to the events surrounding the Covid-19 pandemic. In my experience, many ERCs were designed for the types of risks that emerge in moments such as these and “for such a time as this”. The extent to which ERCs are used to meet risk management challenges of their owners during the current crisis remains to be seen. 