

THE TEAM WITH THE BEST PLAYERS

WINS..... Jack Welch

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Captives Ease the Blow as Commercial Insurance Markets Continue to Harden

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Earlier this year, commercial insurance buyers were reporting annual policy renewals upwards of 25-50%. It was clear that entering 2020 the commercial insurance industry globally was in a *hard market* as premiums had increased for eleven straight quarters (the industry benchmark is ten). In the second quarter of 2020 alone, global average commercial insurance prices increased 19% and are predicted to rise steeply through the end of 2020 and beyond.

An ongoing lower interest rate environment is making it difficult for insurers to remain profitable without continuing to increase premiums as their interest income and investment rates of return continue to plummet. When we add the unknow future costs of the COVID 19 pandemic to the equation, the future looks more and more challenging for businesses.

Overwhelmed business owners and their professional advisors are looking for options. As premiums continue to grow and covered risks continue to tighten, it is natural for them to consider strategies to mitigate these premium increases. **One option is to**

consider whether part of their risk profile is suitable to be covered by a Captive Insurance Company. While this approach isn't applicable for all situations, it is certainly something worthy of serious consideration, especially for many middle market companies. **By considering the addition of captive insurance, many of these companies could benefit from a risk management approach that coordinates their commercial, captive, and self-insurance coverage.**

In addition to the incalculable direct losses from the pandemic, COVID 19 has reminded the entire industry of the impact that one severe event can have on the commercial insurance market.

An example of such a risk that most middle market companies must consider seriously is cyber threat. COVID 19 has increased the likelihood of cyber insurance claims and coverage issues as the lockdowns forced most employees to work from home and many companies to migrate the bulk of their business operations online. Corporate responses to the pandemic also include impact issues such as large-scale network security, loss of potential access to files and the internet, and the potential for devastating business interruptions should there be a cyber-attack due to weakened security.

Many businesses are now faced with offers for cyber coverages that are either too expensive or the limits may not be stringent enough for the business in question and its risk profile. **These companies would be well served in considering coverage of some, part, or all of their cyber risk through a Captive Insurance Company.** While there would clearly need to be other risks and business benefits associated with implementing a Captive, a feasibility study would determine the best ways to approach these issues and whether forming a Captive is a viable option.

Another sector of the commercial market that was seeing significant premium increases before the pandemic is Directors and Officers insurance (D&O) which is now bracing for the impact that COVID 19 litigation and subsequent claims will cause to increase costs. Directors and officers of a company have the responsibility to run their businesses profitably while exercising due diligence in managing business affairs. Failure to do so could expose these directors and officers to personal liability. D&O insurance indemnifies these individuals for losses and defense costs they might suffer as a result of a legal action being brought for allegations of wrongdoing, impropriety, or mismanagement in their capacity as directors and officers of the company. Prior to the COVID 19 pandemic, businesses were already seeing high double-digit increases, approaching triple digit increases in their D&O premiums. The pandemic is likely to make these staggering premium increases even worse.

Insolvencies, litigation due to specific COVID 19 outbreaks, and many other related claims, could be blamed upon a business' reaction, or lack thereof, to COVID 19 risks, protections, and protocols. We see such litigation already beginning, as many major cruise ship lines are being sued all over the world. In an attempt to keep operating, it now seems that they were mishandling their businesses and putting passengers in potential danger at the onset of the pandemic. These situations can put directors and officers in a situation where they may need to access their coverage. While D&O insurance is complicated and some subsets of these risks cannot be covered in a Captive, there are certainly ways to utilize a Captive to help mitigate these premium increases.

It is clear that there is no end in sight for the hardening of the commercial insurance markets, especially for middle market companies. It is incumbent upon these business owners and their advisors to seek out options that address this long-term and potentially untenable expense to their risk management profile.

The consideration of Captive Insurance should be on their radar. In most cases, it would be well worth the time and money to engage in a captive feasibility study to determine if this approach makes sense for the long-term financial health of their business.

Call Independent Captive Associates, LLC sponsored by the National Network of Accountants, to learn how to get started.

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