

Captives Provide Banks with COVID-19 Coverage and Many Other Benefits

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COVID-19 has been presenting significant challenges for US businesses across every industry and community banks have had to respond to some unique circumstances. Most banks' commercial policies exclude coverage for pandemics. A Bank can form a captive to complement the commercial insurance program.

WHAT IS A CAPTIVE?

A captive is a legally licensed, limited purpose, property and casualty insurance company owned by the bank holding company, which can provide *customized policies* for the bank (and any affiliated subsidiaries) where the bank's commercial policies have limits and exclusions.

HOW CAN A CAPTIVE BENEFIT A BANK IN THE CURRENT ENVIRONMENT?

Pandemic Insurance Coverage: Nearly all commercial property policies exclude coverage for a pandemic. The captive has comprehensive business interruption coverage that is providing its banks with needed relief, covering expenses such as, but not limited to:

- A portion of expenses related to the purchase or lease of computers and equipment for employees to work from home
- Expenses related to deep clean branches or facilities that have had exposure to COVID-19
- Costs associated with installing plexiglass barriers for tellers in bank branches
- Expenses associated with the purchase of personal protective equipment (PPE) to keep their employees and customers safe through the pandemic



Increasing Commercial Insurance Rates:

At a time when community banks are worried about the potential impact of a serious recession on their institutions, they are hearing from their commercial insurance brokers that they can expect up to 30% increase in D&O coverage and an average of 12% increase for their FI Bond. A captive insurance company has always been an excellent tool for companies to help manage the hardening commercial insurance market. Banks can evaluate higher commercial deductibles to offset these increased commercial premiums. They can then self-insure these larger deductibles through their captives.

Increased Potential for Cyber Crime

Losses: The remote, work-from-home environment has presented significant challenges for community banks and their commercial customer base. Banks are concerned about the increased risk related to cyber-crimes. The purchase of additional cyber coverage on the commercial market has sky-rocketed, but most do not fully understand what these coverages exclude. A captive can provide a solid backstop for a community bank, stepping in to provide coverage when a commercial coverage is denied because of an exclusion.

Margin Compression: Banks are facing uncertain times and continue to see their earnings come under pressure. Depending on the structure, captive coverages and claims experience, community banks with captives generally experience a 1-2% annual average increase in earnings.

Recently, KeyState hosted a virtual educational seminar with 60 community banks with captives from across the country. The banks attended the seminar better understand how their captive policies would respond as the pandemic developed. After the session, KeyState surveyed the banks (average asset size between \$1B - \$10B) and found that on average, banks estimated \$50,000 to \$100,000 in extra expenses associated with COVID-19, with some of the larger institutions estimating expenses over \$250,000. Although the banks remain disappointed that their commercial insurance does not cover any of these losses, they are thankful to have the captive structure in place to respond to these extra expenses related to the pandemic.

A captive offers a unique and customized approach to help identify and fund for those risks on an annual basis. Typically, banks with holding companies and total assets over \$1 billion can form and benefit from a captive insurance company. There has been continued growth in the number of banks forming captives across the country and specifically in Michigan. The state of Michigan has a competitive captive insurance statute and a service-minded professional team of captive regulators. This makes the formation and operation of a Michigan captive very manageable.

To date, three members of the Michigan Bankers Association have captives. We expect to see more banks form captives as they see how their peers utilize them to address unfunded risks at their institutions.

Since launching the Bank Captive Program in 2012, 27 state banking associations, including the Michigan Bankers Association, have endorsed KeyState's Bank Captive Program. For additional inquiries, please contact Travis Holdman at (260) 227 0265 or tholdman@key-state.com.