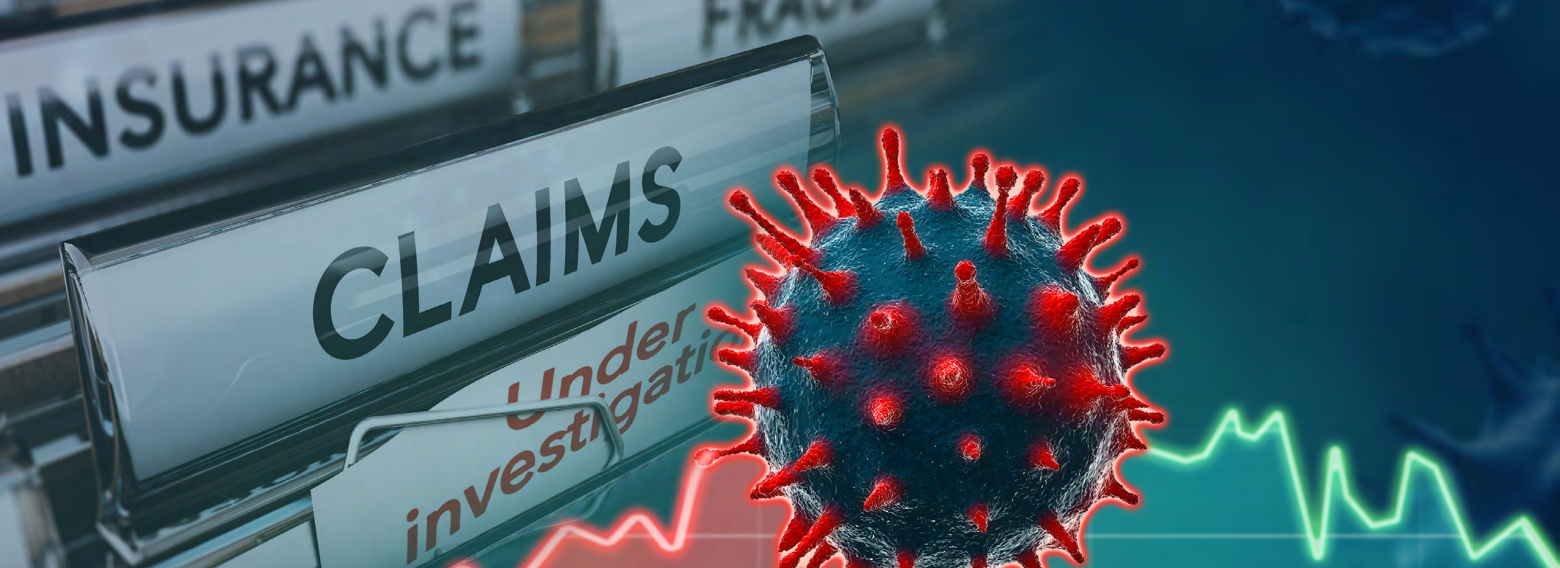

COVID-19 Insurance?

By Joshua Miller and David Guerino, KeyState Captive Management, LLC

Community banks more commonly find relief in their Captive Insurance when Commercial Insurance excludes so many things like pandemics

COVID-19 presents significant challenges for US businesses across every industry, and community banks have had to respond to some unique circumstances. As we focus on moving toward recovery, nearly everyone agrees that some changes to operating environments will be permanent and this is the "new normal." When community banks adjust to these changes, it will be critical for each bank to evaluate their insurance and risk management programs to ensure they can respond in the future. Community banks have incurred significant expenses in responding to COVID-19 and nearly every major commercial insurer is asserting that losses related to the pandemic are excluded under their policy language. Public health experts indicate that the vaccine for COVID-19 may not be widely available until mid-2021 and that future, significant and severe pandemics are inevitable. All companies must have a plan to address the future challenges and considering a more holistic and comprehensive insurance program that identifies and addresses risks that commercial insurers will not.

This is where a captive comes in. 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. The captive does not replace a bank's commercial insurance program. It wraps around the commercial insurance, covering commercial deductible layers, providing some excess coverage, and filling in gaps and exclusions. The current crisis demonstrated the significant financial benefit a captive can provide to a bank.

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:

- 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% increases 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 and 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.

Banks Facing 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 can experience a 1-2% annual average increase to earnings per share.

The captives have begun to reimburse its owner/affiliated entities for reasonable expenses that are not covered by its commercial policy. Therefore, the extra expenses spent on laptops, software, extra IT work, cleaning due to infected employees and/or customers entering a branch, temporary barricades in teller lines, etc. are covered by a captive managed by KeyState under Extra Expense and Difference in Conditions policies.

Recently, KeyState hosted a virtual educational seminar with 60 community banks with captives from across the country, joining to 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-$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 respond to these losses, they have been thankful to have the captive structure in place to respond to these extra expenses related to the pandemic.

Of course, this solution of forming and operating a captive insurance company is not a fit for every bank. This solution should only be implemented by banks with sufficient capital and earnings. Holding companies that want to form a captive must be well managed and well-capitalized. We expect to see continued growth in community banks forming captive insurance companies. As banks become more aware of their unfunded risks through ongoing enterprise risk management, a captive offers a unique and customized approach to help identify and fund for those risks on an annual basis. B

About the authors: Joshua Miller, CEO of KeyState Captive Management, LLC, launched KeyState's Bank Captive Program in 2012. David Guerino, SVP & Managing Director – Captive Insurance of KeyState Captive Management, LLC., recently joined the company and brings with him over 23 years of captive management experience. Since launching the Bank Captive Program in 2012, KeyState has had 85 banks join the program. Banks interested in exploring whether a captive insurance company is a good fit for their institution should contact David Guerino at (802)233-2624 or dguerino@key-state.com or Travis Holdman at (260)227-0265 or tholdman@key-state.com.
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