

KEYSTATE: ADDRESSING ENTERPRISE RISK WITH CAPTIVES

BY JOSH MILLER

Bankers know that not all enterprise risk is addressed with their commercial insurance packages. Emerging risks such as cybersecurity and reputation risk create significant exposures for banks of all sizes. At the same time, commercial insurance carriers are pushing banks to higher deductibles, and there remain significant gaps in coverage and exclusions in commercial insurance policies. This creates unfunded risks, which must be evaluated as a part of any bank's enterprise risk management process.

A growing number of banks throughout the country are forming captive insurance companies to cover these unfunded risks. A captive is a legally licensed, limited purpose, property and casualty insurance company, which can write customized policies for related entities. A captive structure does not replace any of a bank's current commercial policies. Instead, the captive can augment the commercial policies by covering the bank's commercial deductible layers, increasing coverage levels on existing policies (excess layers), and identifying other currently unfunded risks to insure where commercial insurance is not available to the bank.

Along with the benefits received from enhancing the bank's risk management process, Congress approved a small-business incentive whereby a company (including banks) can form its own captive insurance company and then make an election under Section 831(b) of the Internal Revenue Code. This allows companies to pre-fund for potential future risks on a tax-advantaged basis, providing an incentive to set money aside for future potential claims and a mechanism for companies to formalize their current self-insurance programs. In the December 2015 Appropriation Bill, Congress moved the annual allowable premium limit from \$1.2 million to \$2.2 million for the tax years after 2016.

BancServ Endorsed Partner KeyState Captive Management Company LLC assists banks with the establishment of a captive insurance subsidiary, allowing banks to expand their coverage (over and above their commercial policies) and improve overall risk management.

KeyState works with the bank, guiding it through the various steps of implementation. The first step is the preparation of an independent assessment of a bank's current commercial insurance coverage,



which provides a detailed peer comparison for each commercial policy (benchmarking coverages, limits and deductibles). The assessment is then used to identify and select the coverages that the bank will place inside its wholly owned small insurance company.

KeyState and the Indiana Bankers Association began introducing this program to banks in 2012, initially targeting banks that are \$450 million in assets or larger in Indiana where KeyState has a long history. By the end of 2014, about 90 percent of Indiana banks in that asset range implemented the Bank Captive Program.

To date, 40 banks have taken advantage of this program, including one Florida bank. Dozens of other banks are currently completing various stages of due diligence. The participating banks are in one of four established risk-sharing pools created to spread larger events of risk throughout the pool.

KeyState's Bank Captive Program has been endorsed by the Florida Bankers Association and 19 other state bank trade associations. KeyState will continue to expand this offering to banks throughout the country, further enhancing the risk distribution profile of the program.

The multiple benefits of improved risk management, expanded coverage availability and other benefits may make the formation of a small captive insurance company advantageous for your bank. If you have further interest in evaluating the formation of a small captive insurance company, please contact Josh Miller with KeyState at 702-598-3738 or jmiller@key-state.com.

To learn about the products and services offered by BancServ Endorsed Partners, contact Director Jim Seay at 850-224-2265 or jseay@floridabankers.com. 