

COVID-19 and Captive Insurance



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COVID-19 is presenting unique challenges for community banks, along with most other organizations. From an insurance standpoint, businesses have learned quickly that most commercial policies exclude coverage for pandemics.

Community banks, along with other mid-size companies, can establish a wholly owned captive insurance company (a “captive”) to complement their commercial insurance program and afford coverage when commercial policies exclude it. Banks can utilize their captives to pre-fund and establish a rainy day fund for risks that are excluded from their commercial policies, rising commercial deductibles, and emerging risks that the commercial insurance marketplace have not addressed.

KeyState manages captive insurance companies for over 80 banks across the US. Each of those banks has submitted (or plans on submitting) claims related to COVID-19. Most of the banks we work with that have formed captives are \$1 billion to \$15 billion in total assets. Their COVID-19 claims have ranged from \$40,000 for our smaller institutions to \$400,000 for our larger ones. Banks have been pleased to have their captives in place to cover these losses, especially given the current environment with uncertain earnings and compressed margins.

“We joined the Bank Captive Program in 2014 and have experienced significant economic benefit and enhanced risk management from the structure for many years. I’d encourage our peers in New York to evaluate whether the captive is a good solution for their bank.”

- Don Gibson, CEO The Bank of Greene County

Typical claims submitted to the captive by their affiliated bank:

- ▶ Expenses related to the purchase or lease of computers and equipment for employees to work from home (of which the captive will reimburse the bank for a portion while in use during the pandemic)
- ▶ 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
- ▶ Expenses associated with hosting their annual shareholder meeting virtually

Beyond coverage for losses related to the pandemic, community banks face a challenging environment as it relates to their commercial insurance programs. As they renew their commercial packages, many banks are facing increases in their commercial D&O premium of more than 25% and over 12% for their financial institution bond premium. With ransomware attacks at an all time high, cyber coverage is becoming more expensive just as commercial carriers are adding coverage exclusions and increasing underwriting scrutiny. Banks can help offset these premium increases by raising their commercial deductibles, but they take on more risk in the process.

Community banks can respond to these challenges by forming a captive as one part of their larger enterprise risk management framework. A captive allows a bank to pre-fund for risks not covered commercially. At the same time, a properly structured captive can result in management's increased visibility and focus on their unfunded risks. This focus ultimately reduces and limits losses for the entire organization. **Captive insurance companies are a tool that community banks can use as they take a more proactive approach to enterprise risk management. They also provide banks with a mechanism to respond to the hardening commercial insurance, helping them to address rising commercial premiums, higher deductibles, and broader policy exclusions.**

Typically, banks with holding companies and total assets over \$1 billion can benefit from a captive insurance company. Over the past 5 years, there has been continued growth in the number of banks forming captives across the country. Since endorsing KeyState's Bank Captive Program, 3 members of the New York Bankers Association have formed captives. All of the NY banks that have joined the Bank Captive Program have found that their captives perform as anticipated, enhancing average annual bank earnings by 1-2% per year.

Since launching the Bank Captive Program in 2012, KeyState has had 85 banks join the Program. KeyState has been endorsed by 26 State banking associations, including the New York Bankers Association.

For more information on the Bank Captive Program, please contact:

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