**Extract from the Captive Review and Labuan IBFC webinar titled "Captivating Covid-19: Pandemics, Parametric and Risk Pooling" held on Thursday 30th April 2020.**

**Lauren Ingram, Editor Captive Review (LI):** We have an excellent panel, which I am very excited to moderate. We have got Olly Schofield, Managing Partner at RISCS and Head of Captive & ART Consulting at Principal Re, Farah Jaffar-Crosby, CEO of Labuan IBFC and George McGhee, Managing Director of Asia-Pacific Captive Practice at Willis Towers Watson. Let us start with an opening statement on Covid-19 and Captives

**Oliver Schofield, Managing Partner, RISCS and Head of Captives & ART Consulting, Principal Re (OS):** Thank you for inviting me to be part of this event and good morning, good afternoon, good evening to everybody. This obviously is an absolutely devastating event in so many ways and our thoughts are with everyone who has lost loved ones or have been impacted in any other way. Captives have always had a role to play in the world of insurance, especially in times of catastrophic loss and subsequent economic downturn. If we cast our minds back, whether it be to post 9/11, post Katrina, Rita, Wilma or even back further to the 1980s global liability insurance crisis, captives have clearly already shown their resilience and stepped up to bring cover and pricing stability and coverage innovation to their parents. And I passionately believe that this time will be another great opportunity for captives to demonstrate their lasting value to the industry as a whole. I think we should keep in mind that this will be the single largest insured loss event in history. There will be immense pressures on all of us in the insurance and reinsurance industry, regardless of what sector we represent, whether that is financially, whether that is reputationally or whether that is socially. I think collectively as a group we have to stand tall. We have to stand together, work together and find creative solutions for businesses going forward.

**LI:** How can captives play a part with pandemic insurance following something like covid-19. What can captives do in a situation like this when people are looking at pandemic insurance as an option?

**OS:** I think in the context of where we are in the market, captives can play a very significant role going forward. The pressure that is going to come from the market will come in four different areas, which I refer to as the Four Horsemen of the Apocalypse. The first one is the pressure that is going to be put on organisations to take increased corporate retentions. The second area is increased premiums that insurers and reinsurers are understandably going to be demanding for coverage in general. We have been in a hardening market now for some time and certainly with this event being the largest loss that we have ever faced in history, you can only expect premiums to continue to come under pressure. I think the third area that we are going to see pressure is in the wordings. Now some of that will be welcomed because it will be clarifying the intent of coverage, and there are lots of discussions going on at the moment about whether or not losses should be covered or are covered, so clarity of wordings is important. However, it can also be used as the opportunity by insurers to reduce and restrict cover. The fourth area is in terms of monetary capacity that is available in the marketplace. We have already seen certain segments of the market shrink, with rather large withdrawals in terms of capacity that is available. Only two weeks ago an organization in UK published a report that showed 30 different insurers had pulled out of the corporate and personal travel insurance space. That is a significant reduction in capacity. So, if you look at those four areas, retentions, premiums, wordings and capacity, these are areas where captives can absolutely support their parent organization. If those organizations

already have captives, they are of course well placed to absorb and mitigate against these changes and their captives can look to increase their gross retentions, they can look to increase the coverage that they offer to their parents. However, those organisations that don't yet have captives should perhaps now start considering whether or not it is worth their while establishing captive vehicle so that they can then manage the instability that we are going to see in the marketplace accordingly . I think it's also worth considering along with the establishment or expansion of the captive, what the actual size of this loss means to their parent company and therefore their ability and their appetite to retain risk, because it is all very well sitting here and saying you should increase your retentions and you should offer broader cover, but obviously that has to be within the restrictions of the affordability of those increased retentions and the risk appetite that organizations have. I think it is perhaps time that organizations consider if they might have a better risk appetite than perhaps, they originally thought. Furthermore, in the event that we have this situation a second time, another massive pandemic or another loss that impacts the world in a similar way, if organizations have not built up the financial muscle within their captive then they are still going to be in the same position as they are now, so a relook at their appetite and their ability to retain risk is essential.

**LI:** What is the role of financial inclusion in a pandemic

**OS:** I think it is incumbent upon government to work with industry to provide solutions for the unprecedented, unimagined losses that are happening. We saw very quickly how certain governments around the world announced emergency financial packages for organizations be it here in the UK, the US or elsewhere, but I think also we need to consider the impact that this event is going to have on those individuals who do not have the same protection net that we might have in other countries. We need to act on some of the reports that are coming out of some parts of the world where people simply have not had the wherewithal to purchase insurance, do not have regular jobs and do not have a regular form of income. These are the ones who are absolutely falling outside of safety nets put by governments around the world. So whether it is the World Bank, the World Food Programme, or other parts United Nations stepping in and providing a community-driven protection in conjunction with our sector, be it for crop insurance or other forms of farming exposures, we need to do so. A well-known example is of course Seadrift. These are so fundamentally important if we are as an industry and as a world going to take front-and-centre responsibility for the social aspect of massive losses such as these.

**LI:** There has been some talk of government introducing federally backed pandemic insurance programs.

**OS:** I think from an insurance perspective we all need to be very, very clear that as always in our insurance world policies will respond and will pay for this event where coverage has been purchased and paid for. Personally, I feel it is completely wrong for government anywhere in the world to step in and demand that insurance policies pay where there is a clear exclusion in the policy or there has been a clear decision by the buyer not to pay the additional premium to purchase the exposure. That is not the role of the insurance industry. Our role is to pay valid claims swiftly without any kind of confusion or deliberation. But, having said that I recognize there is a role and there is a need for government to step in as insurance providers of last resort as significant number of businesses right now around the world are facing ruin. Some would ask why should government protect businesses because after all businesses and succeed and businesses fail and if they have not planned properly, why should they get a government bailout? And I think the answer to that goes into very much what the Labuan IBFC have been championing now for some time which is the massive social impact. If these businesses are

allowed to fail then there will be a significant number of people who no longer have the livelihood to enable them to survive. We are talking about basic human survival in many parts of the world. So yes, government has a role and as taxpayers be it corporate taxpayers or personal taxpayers, we will have that responsibility to pay our taxes to ensure that governments have the wherewithal and the World Bank has the wherewithal to be able to step in and provide support. I look at this in two ways: the immediate role and the ongoing role. The immediate need is to bring economic stability to countries around the world; that is being promoted already by certain countries. The second and perhaps in my view more important is bringing social stability. We have not yet seen some of the mass social breakdowns that we saw after certain events around the world, think back to the days of the Los Angeles riots which went on for several days and the London riots that happened not so many years ago. That is a breakdown in social order that we have not yet seen and that is wonderful, it is gratifying. But financial and social relief measures need to be designed to stop that economic and social order collapse that could come about due to people having to spend significant amount of time in lockdown under various movement order restrictions. From an ongoing perspective clearly the insurance market will never be capitalized to a level where it can provide cover for absolutely everything in an unrestricted, non-aggregated way. So as the insurance market cannot provide suitable economically attractive cover going forward for absolutely everything then government in conjunction with the insurance industry experts should be looking to provide these solutions at the appropriate cost. Now to me that is essential for those businesses that are particularly too small for the captive or the risk pooling route. Current examples that have already being announced and are being considered include the Steven Catlin led initiative Pan-Re, certain insurance leaders in the US, Greenberg from Chubb amongst them, are talking about PRIA, so the pandemic version of TRIA in the US. Now, this is obviously a very well-trodden path as vehicles already exist, so it should not be beyond the wit of all of us being able to promote and drive these new vehicles and to do it now for when the next big event happens because there are concerns that covid-19 will resurface: we saw some of the restrictions being relaxed in Germany last week yet now there has been an uptick in the number of people who are infected and dying so we need to get something in place fast - and that should provide a combination of social and financial protection for this existing event as well as future events.

**LI:** Covid-19 has had a massive impact on the world which obviously means a massive impact on the insurance industry, so what are the main lessons that we can learn from covid-19 for Risk Managers in particular?

**OS:** From Risk Managers' perspective, I would be looking to my brokers, my advisers, and my insurers to see what options there might be for me to be able to build up the necessary protection that I need. So, I would look at two different areas. The first one will be parametric solution. There were already a few parametric pandemic deals that had been structured before this event because there were some organizations that recognized that any kind of impact like this or even to a small degree like this would have a devastating knock-on impact their business. We will just have to wait and see how it transpires from the point of view of whether they are going to be triggered. I am not familiar with the specific trigger indices that exist in those deals so I cannot comment on that. There is already a certain amount of activity in the parametric space for new products as we will work collaboratively to build solutions for the future pandemics. These are tailored to pools of business be they be broken driven pools of business or even business driven by mutualisation of risk. It is important to recognize that these will not be cheap solutions, but they will be valuable solutions, as current pandemic parametric covers are proving. That brings me onto the concept of risk pooling. This too is a successful well-trodden path used by corporate buyers on various occasions in the past, when cover was either no longer available, was economically unattractive on a first loss basis, or only available with significant retentions and

coverage restrictions. Typically we would see a blend of various different types of structure as follows: a captive participation, then in the next layer a mutualised or pooling structure, then higher up in the program a pooled parametric pandemic or pooled parametric catastrophe cover – these therefore bring to the risk manager a solution that is much more cost attractive and coverage broad. We have examples of these from the past, most notably from the 1980s when the oil industry set up OIL and subsequently OCIL, the rail sector setup TRAC and RAIL in North America, and of course Ace and XL, two very well-known insurance companies today, were set up by Marsh back in 1980s to provide excess casualty / liability cover to their North American clients because the casualty market had vanished almost overnight. So, there is precedent for this, they are successful, they work well and they provide the risk manager with options as to how they can buy the best coverage at a price that becomes economically attractive to their own organizations. The challenge always with these vehicles is when you ask companies from the same industry group to start sharing information about their risk, their expenses their exposure, because they do not like sharing that information, but I think needs must and they must put aside some of the reservations about information being shared and revisit these well proven approaches.

In summary, I think the key thing that we always keep in mind is this is not only about the insurance industry's financial response; it is also about capital markets response, the financial markets response, the general business response and societal response to ensure that we can come out of this and come through the other side in the best possible shape.

**LI:** One of the top questions here is can we get a more precise on how specific pandemic reinsurance can look

**OS:** The reinsurance industry of courses underpins the operation of the global insurance sector. The reinsurers are often able to put together programs that are potentially broader than the direct insurance industry as certain reinsurers are the ultimate risk takers and do not purchase their own retro-reinsurance. Therefore these reinsurers decide based on their knowledge and breadth of experience as to what cover they feel they can offer in certain circumstances and there are the ones that are behind the driving of new creative solutions such as parametric multi class portfolio protections. If I were looking at putting together a pandemic solution for captives on a reinsurance basis, I would look at it on a portfolio multi-class basis. I would also look at it on a multi-year basis. We can define things as business interruption or property or liability casualty or travel or contingency, however, when in the captive environment what we are interested in is the fact that a company has risk and how are we going to help them protect themselves from that risk? And one of the most efficient ways of doing that - and this is why insurance companies do it themselves - is to purchase portfolio protection, or treaty protection, whether that is on a country-by-country basis, whether it is on a global basis, whichever it doesn't matter, but buying that portfolio protection as a captive enables you to try to eliminate any gaps in cover between whether the pandemic loss should be classified for example as a contingency loss or a cancellation loss. Those discussions go away because it will be overtly written in the reinsurance policy that it provides cover for pandemic across the portfolio of all of the captive's parent's operations. I think we need to start making captives think about portfolio purchasing. I have been banging that drum for years and it has often fall on deaf ears, not because it is too expensive but I think it is quite a complicated; also traditional insurers do not like the idea of portfolio underwriting as there is an economic challenge that they face and accordingly prefer to offer their capacity on an individual lines basis.

**LI:** Are there any captives that had pandemic insurance or reinsurance for this covid-19 event?

**OS:** Yes, very much so. An exercise was undertaken a few years ago to help organizations consider what the worst-possible-case scenario would be for their for their business and as a result of that work, certain businesses actually went out and purchased cover that had a specific pandemic extension through the program. Some of those organizations would have bought that cover through their captive, some of them bought it direct from the insurance market; I suppose the most noteworthy and perhaps the most well-known example as it has been reported in the press all over the world, is the policy that Wimbledon Tennis took out via Marsh for the exposure that they would face further from the cancellation of the annual Wimbledon tennis tournament as a result of a pandemic. So yes, the cover does exist, or did exist rather, and yes, organizations overtly went out and purchased it and indeed some of those sought to run that exposure through their captive and sought captive reinsurance accordingly. Other organizations will have built up their own funds on their own captive's balance sheet to provide for these type of Black Swan events, and I am aware of several captives that specifically had all risks policies that would cover a multitude of different events so that they could just continue to operate their business; in particular think of the hospitality space where the bottom is falling out of their industry completely and whether it is just providing the ability to continue to pay wages, whether it is the ability to continue to pay the rent when they have had no income, if the policy is structured in such a way that is very broad all risk coverage, then the captive can underwrite their own coverage and can decide exactly what is covered and what is not covered.

**LI:** The final question is about loans or dividends to parents versus retaining funds for future balance sheet strength, to allow a captive to provide capacity in the future.

**OS:** Loans can of course be made to the parent so long as course they are made in a fashion that is acceptable to regulator in the particular jurisdiction that the captive is located in. But regarding dividend payments certainly our recommendation is always do not think about trying to dividend anything back to the parent within the first five years of the captive's life; use any profits to build funds to pay for future losses, losses that as you go into year two, three, four, five of the captive's life you could use to expand the captive's breadth of underwriting to cover some of these unforeseen, unknown events under some form of very broad all risks cover. If you start dividend that money back to the parent after year one, then what purpose does the captive actually serve in longer term risk management planning? What it becomes instead is a "let's make a quick profit and get that back into the parent company" instead, and then the focus on risk management and profit generation within the captive just goes out the window. So definitely loans to parent if needed rather than dividend payments.

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