

# The Wild West

## Transforming challenges into opportunities with captives in Utah

### **Cannabis Captives**

How does the cannabis insurance industry address risk?

### **Business Interruption**

The impact of the COVID-19 pandemic on the demand for BI insurance



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### Connecticut records 59% growth in captive insurance companies in 2021

The Connecticut Insurance Department has announced a 59 per cent jump in captive insurance companies in 2021, with 13 new insurers being approved by the department. The licences granted by the state comprised new captive formations and the redomestication of some captives to Connecticut from other domicile states. Since licensing its first captive in 2012, Connecticut has seen a growth in the number of captives over the past two years, from 16 entities to 35 in 2021. Currently, one-third of all Connecticut captives are owned by Fortune 500 companies, primarily covering risks where insurance is not available in the commercial market or is too expensive.

Commissioner Andrew Mais comments: “This was another exceptional growth year for Connecticut-domiciled captives as businesses leveraged them to strengthen their insurance coverage, fill gaps and reduce risk.”

The record growth reflects the growing awareness of the high value a captive domiciled in Connecticut can provide, in large part due to the concerted efforts of the department and various stakeholders, according to the commissioner.

Fenhua Liu, assistant deputy commissioner of the captive insurance division, adds: “Captive insurers are growing in popularity. They allow businesses of all disciplines to control costs while better protecting their assets and reinvesting those savings back into their business operations. When a business can better control its costs, it can better control its destiny.”

### WCF: COVID-19 has fuelled interest in medical stop-loss captives

The COVID-19 pandemic has “lit the spark” for increased interest around medical stop-loss captives, as was discussed in a session at the World Captive Forum in Miami last month.

The market impacts of the pandemic have favoured self-insurance programmes with layered contractual relationships, observed Karin Landry, CEO of Spring Consulting. She added that there has been a significant growth in spend through traditional pharmacy benefit managers, which usually accounts for between 20 and 30 per cent of spend on any given programme.

As the world gradually emerges from the pandemic, data-driven priorities around medical stop-loss solutions include pharmacy, disease regression strategies, behavioural access and literacy, healthcare navigation, and additional networks solutions, said Landry.

In particular, point solutions — a specific service offered by a vendor within a benefits programme — were identified as a key provider of efficiency. Landry noted that of the organisations that offer point solutions, second opinion and medical opinion programmes are the most common (51 per cent) service purchased by a vendor.

In the session, David White, vice president of AIG Captive Solutions, highlighted that the most important consideration when joining a medical stop-loss captive is the formula for which the captive shares profits and losses.

A real-life example of a medical captive operating throughout the pandemic is edHEALTH, which was discussed during the session. Tracey Hassett, CEO and president of edHEALTH, observed significant changes in the behaviours of employers since the pandemic.

For example, the majority of US health plans now cover the cost of COVID-19 tests as the world gradually shifts into an endemic — however, if the healthcare plan is self-insured, this cost then goes back to the employer.

Another problem arising from the pandemic is deferred care, as people either put off going to the doctor if their condition is not COVID-19-related, or take longer to receive a diagnosis as hospitals shift their priorities.

This means that many people then require more advanced, and therefore more expensive, treatment.

This, along with other COVID-19-related healthcare costs, places stop-loss captives in a prime position to offer accessible and affordable solutions, the session concluded.

### Delaware amendments allow use of captives for D&O cover

The Delaware state legislature has passed Senate Bill 203 to amend Title 8 of the Delaware Code, allowing corporations to use captives for directors’ and officers’ (D&O) liability insurance.

Section 145 of the title, relating to the indemnification of officers, directors, employees and agents, previously set out limitations that meant corporations had

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no alternative but to buy traditional D&O insurance policies.

Under the new bill, the section is amended to include: “[A]ny insurance provided directly or indirectly (including pursuant to any fronting or reinsurance arrangement) by or through a captive insurance company organised and licensed in compliance with the laws of any jurisdiction.”

The bill notes that this inclusion is contingent upon such captive insurance companies adhering to the relevant codes of conduct, for example, exclusions from coverage attributable to any personal profit, or the use of an

independent claims administrators. In July 2021, Delaware passed Senate Bill 36 allowing captive structures to be classified as registered series, clarifying provisions around insuring a parent company, and allowing a captive to enter dormancy after 12 consecutive months of inactivity, rather than a calendar year of inactivity.

**Bermuda’s captive industry launches The Bermuda Captive Network**

The Bermuda captive industry has launched The Bermuda Captive Network,

a membership-focused organisation providing education, business development and representation for Bermuda’s captive and managed insurance industry.

The network aims to reflect the innovation and collaborative approach of the growing Bermuda captive market, while continuing to promote Bermuda as a domicile in the global risk market.

The network emerged from the collaboration of the Bermuda Insurance Management Association, Bermuda Captive Owners Association and the Bermuda Captive Conference.



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The Bermuda Captive Network strategy team will include Scott Reynolds, president and CEO of American Hardware & Lumber Insurance and president of the Bermuda Captive Owners Association, and Grainne Richmond, vice president of strategic risk solutions, Bermuda and president of the Bermuda Insurance Management Association.

Other members include, but are not limited to, Leslie Robinson, who is senior vice president and head of underwriting and claims at Willis Towers Watson Management Bermuda as well as chair of the Bermuda Captive Conference, and Nicola Hallett, director of captive and commercial insurance at Artex Risk Solutions.

### **Lockton receives approval to form captives for Cook Islands companies**

The New Zealand operation of independent insurance brokerage Lockton Companies has been approved as a licensed external captive insurance manager to establish captive structures with Cook Islands international companies. Lockton Companies NZ Limited Partnership (Lockton NZ) was formed in September of last year to administer risk and insurance services across a range of specialisms, territories and industries.

As a global risk management partner, Lockton's captive and alternative risk transfer segment provides consulting and management services, including feasibility studies, domicile management, licensing and incorporation, regulatory consulting, and reinsurance design, advice and placement.

The Cook Islands has operated as a captive domicile since 2013, offering knowledgeable professional service providers and modern, practical legislation and regulations for financial services providers and their businesses.

Following a meeting with Lockton NZ representatives, Marie Francis, CEO of Cook Islands Finance, comments: "We are thrilled that Lockton NZ has been approved as a licensed external captive insurance manager and is establishing captive insurance structures with Cook Islands international companies.

"The Cook Islands has an excellent reputation for its international compliance and professional services. In these uncertain times it is advantageous for New Zealand and Australian clients to establish captive insurance structures in a nearby jurisdiction which has a close association with New Zealand."

Jessica Schade, head of captive and alternative risk transfer at Lockton NZ, has been involved in establishing and licensing all captives currently registered in the Cook Islands, while Ged McCombie, head of Pacific, will provide risk solution capabilities to clients.

Schade adds: "I have worked with the Cook Islands Government for a number of years and have always been impressed with their willingness to work with business, insurance experts and interested parties in crafting best-in-class captive legislation and a world-class captive insurance domicile. It gives me confidence in their commitment to the captive insurance industry and the business needs of New Zealand, Australian and Asian companies."

### **IGP launches centre of expertise for captive and global underwriting programmes**

International Group Program (IGP) has launched a centre of expertise for innovative global employee benefits solutions, including reinsurance to captive and global underwriting programmes.

IGP notes the centre was formed to address ever-evolving business requirements to manage biometric risk in the context of local regulation changes, technological and data analytical developments, and the increasing importance of ESG criteria.

In addition, the centre will provide the commercial strategy, service delivery, administration and technical oversight that risk managers, finance managers and legal functions require for such insurance and underwriting programmes.

The centre includes a dedicated business unit for all corporates and their advisors, as well as flexible product design, data-driven underwriting support and portfolio governance, and a bespoke operating platform.

Alongside its core multinational pooling programmes and employee benefits programmes, IGP has expanded the offering to next-generation global underwriting and reinsurance to captive programmes.


This includes a redesigned operational workflow that expedites the implementation of captives, whether a transition from a pooling programme or a standalone inception.

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**One80 acquires captive and alternative risk solutions provider**

Specialty insurance brokerage One80 Intermediaries has acquired Innovative Risk Management (IRM), a programme manager providing captive and alternative risk solutions to agents, brokers and self-insured entities. The transaction includes Programs Plus, which administer underwriting management and policy administration services for self-insured entities, captives and specialty programmes. Under the acquisition, IRM will become a division of One80. The insurance wholesaler and programme manager offers programmes across a range of coverages,

including property and casualty, cannabis, medical stop-loss, alternative risk and health risks.

IRM offers its captive solutions and customised insurance programmes to improve risk profile, control losses, and manage claims.

Solutions include captive solutions, programme management, claims mitigation and administrations, underwriting, loss control and specialty programme development and management.

Matthew Power, president of One80, comments: "I am excited to offer captive

and alternative risk solutions through the One80 platform with the acquisition of IRM. As we continue to bring together the best talent in the industry, I am confident that IRM's highly specialised and innovative team will be a fantastic addition to the One80 culture."

Stuart Stagner, managing director at IRM, adds: "For 30 years, IRM has consistently provided a unique approach to alternative risk solutions."

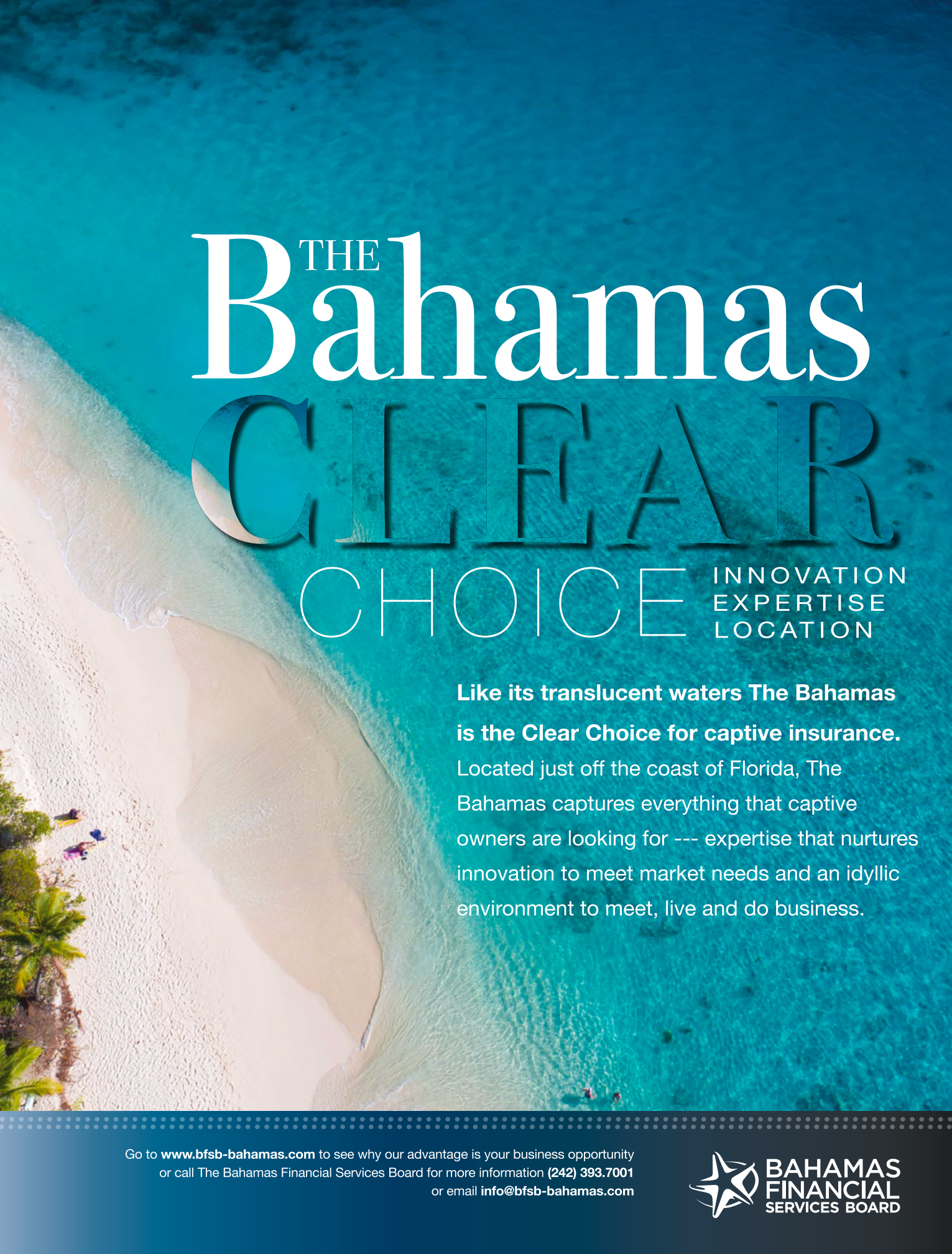
"As IRM moves into our next 30 years, we will partner with One80 Intermediaries to provide our clients with an expanded platform for growth and opportunities."

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### Kansas amends captive legislation to authorise TEFFIs

The legislature of the state of Kansas has passed Senate Bill 377 to authorise and provide for technology-enabled fiduciary financial institution (TEFFI) insurance companies within the Captive Insurance Act.

The bill, which was referred to the Committee on Financial Institutions and Insurance on 25 January, passed with 36 votes to three.

Under the amended legislation, TEFFI insurance companies are authorised to provide contracts of suretyship or credit insurance to any affiliated TEFFI, affiliated fidfin trust, or any other affiliated company against liability, loss or damage resulting from fraud, theft or indemnification.

Essentially, this allows these insurance companies to operate as a captive insurance company, with chapter 40 section 4301 of the Kansas Statutes (which establishes the definitions and operations of captive insurance companies in the state) amended to include any affiliated fidfin trust and any affiliated TEFFI under the scope of the definition of an “affiliated company”.

The bill reads: “TEFFI insurance company’ means a pure captive insurance company that: is related to a TEFFI by common ownership; or owns, directly, indirectly or beneficially at least five per cent of the equity interests of a TEFFI, including any equity interests in such TEFFI’s holding company.”

TEFFI insurance companies are subjected to the same coverage restrictions as

pure and association captive insurance companies, for example, they are prohibited from insuring risks other than those of its parent and affiliated companies.

They are also excluded from providing coverages for personal lines of insurance, workers’ compensation, accident and health, employers’ liability, long-term care and critical care.

The TEFFI Act was introduced in Kansas’ 2021 legislative session to define and authorise the activities and services of such institutions. ■



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# The Wild West

Travis Wegkamp and Brandy Alderson discuss the landscape of the Utah captive industry, the regulatory environment, and turning challenges into opportunities

Rebecca Delaney reports

Forming one-third of the Western Region alongside Arizona and Missouri, the captive market in Utah currently boasts more than 360 active captive insurance companies across a range of industries, including but by no means limited to voluntary employee benefits, cyber liability and tenant liability coverage.

Brandy Alderson, president of the Utah Captive Insurance Association (UCIA) and account executive at Marsh Captive Solutions, defines market conditions in the Beehive State as stable, highlighting the robust number of active licences, as well as new captive formations on the horizon.

She notes: “The captive industry is currently experiencing increased growth either in the number of licensed captives or the growth of written premium as captives provide solutions for increased commercial insurance rates or lack of capacity.

“Those captives domiciled in Utah are fortunate to work with regulators that are well-staffed and very responsive to business plan changes and other needs of existing and prospective captive owners.”

This is affirmed by Travis Wegkamp, director of captive insurance at Utah Insurance Department, who describes market conditions in Utah as “excellent”. He adds: “Our diverse economy continues to thrive, and that includes expansion of the captive industry and service provider markets.

“The captive programme here in the insurance department has strong support from insurance commissioner Jon Pike, and from Governor Spencer Cox. While adhering to our chief duty of regulatory oversight, our next top priority is to assist, as appropriate, in the success of Utah captive insurance companies.”





Utah-domiciled captives are regulated under the provisions of the Captive Insurance Companies Act of 2003, which authorises single-parent and group captives (including sponsored and industrial insured captives and risk retention groups).

The original captive legislation of the state does not subject captive insurers to premium tax — although they are still subject to real and personal property taxes — and establishes reasonable capital requirements and annual renewal fees.

In addition, the legislation authorises the licensing of branch offices of offshore captives which underwrite and administer employee benefit programmes to its parent and affiliated companies. Although there are no restrictions on allowable investments, the department does not allow any investments that threaten the solvency of the captive.

In terms of regulatory oversight, Utah captives must file a report on the financial condition of the captive insurance company with the commissioner before 1 March every year, and are due for examination at least once every five years by the Utah Insurance Department.

Alderson adds: “The Utah Department of Insurance submits proposed changes to captive legislation on an almost annual basis. These proposed changes typically enhance the existing legislation and make operating a captive in Utah a more positive experience.”

Some of these more recent legislative amendments include House Bill 50, which was passed in March 2021 to authorise the state risk manager to create captive insurance companies in cooperation with any covered entity that has responsibility for the risk control and safety of school districts and charter schools. This allows schools

districts and charter schools to participate in any captive created by the state's risk manager.

In addition, House Bill 54 of the 2021 legislative session amended the Utah insurance code to ensure the state remains a competitive domicile.

This included a reduction in minimum unimpaired capitalisation requirements for sponsored captives from US\$1 million to \$500,000, as well as a reduction from \$350,000 to \$200,000 from the sponsors themselves.

The bill also allowed captive coverages for punitive damages, although this still prohibited pure third-party direct or indirect coverage, as well as damages arising from a criminal act.

Summarising the regulatory environment of Utah as a captive domicile, Wegkamp says: "This support [we provide] is also echoed by the Utah legislature and demonstrated by their willingness to work with us to continually update and improve captive legislation to ensure Utah remains a competitive and business-friendly domicile.

"In the past 20 years since captive legislation was first passed in 2003, Utah has become a staunch supporter and major player in the captive insurance industry. We pride ourselves in being accessible and open to exploring innovative approaches to a company's risk management programme."

## New horizons

As with any industry, the captive sector is not without its challenges. Utah Insurance Department's Wegkamp outlines interminable scrutiny from the Internal Revenue Services (IRS) over the alleged formation of captive insurance companies for federal tax purposes.

He explains that the fundamental challenge here is a lack of straightforward communication on the part of the IRS over what constitutes a "good" captive from their perspective, as well as how to adequately obtain risk distribution to an apparently acceptable IRS standard without involving the traditional insurance market.

"The IRS' silence and lack of guidance on this matter makes it necessary for captives to explore ways to achieve that distribution. One example being captive pools; however, the IRS is yet to find a pool that it likes."

However, he also adds that, as an inherently innovative industry, captives are able to transform challenges into opportunities. This is particularly apparent with the COVID-19 pandemic, which saw captives step up to meet the needs of their parent and affiliate organisations.

"This ability by captives to more nimbly pivot and provide the necessary coverages needed during this difficult time, like business interruption and supply chain, ended up being a great opportunity for captives to demonstrate their advantages as an alternative risk management vehicle," Wegkamp explains.

It is anticipated that captives will implement similar and new approaches to programmes that aim to mitigate the losses arising from large-scale disruptions, whether from pandemics, climate change or cyber threats — particularly the latter, as increasing digitisation of information and workstations only heightens cyber liability exposure.

This is affirmed by UCIA's Alderson, who notes that emerging risks continue to be driven by challenges in the commercial insurance market, whether cyber liability, excess liability or medical stop-loss, to name but a few.

"Captives continue to help solve business challenges and support strategic objectives for captive owners," she summarises.

Looking to the horizon of Utah's captive development agenda for 2022, Wegkamp reveals that the legislature has proposed an increase to the captive annual licence fee from \$6,125 to \$7,250.

Elsewhere, the department will continue with improvements and updates to information sources concerning online applications, statement forms and prior approvals.

He highlights: "We know having ease of access to these resources and information are important to our captives and those seeking to know more about Utah as a successful captive domicile." ■



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# Ready to roll

As a key emerging market tapped by captives, how does the cannabis industry address risk and insurance in the face of misconceptions and a challenging federal mandate in the US?

Rebecca Delaney reports





The US cannabis industry can certainly be described as a booming emerging industry, reaching an estimated US\$250 million in premiums in 2021 — with Rocco Petrilli, chairman of the National Cannabis Risk Management Association (NCRMA) arguing that, if insured properly and with sufficient capacity, this figure could reach close to \$1 billion, presenting a huge opportunity for the captive industry.

A HUB International report providing a 2022 industry outlook notes: “The cannabis industry is poised for another year of huge growth in 2022, and the enterprises that will benefit the most are those best-positioned to manage risk.”

Despite this anticipated prosperity, risks in the cannabis industry consistently exceed the availability of insurance, owing to its status as a federally outlawed substance, as well as the inherent dangers in extraction and production. In addition to these specific hazards, the cannabis industry also shares the same risks as other more conventional industries, such as catastrophic crop damage, cyber risk, and skilled worker shortage.

In the traditional insurance market, few carriers underwrite cannabis insurance — and coverage that does exist is expensive and often restrictive. Such competitive rates arise when carrier appetite and client risk profile align, as carriers only want to insure cannabis companies with robust risk control practices.

As Eric Rahn, managing director at Alternative Risk Strategies, explains: “The sheer fact is that when an industry shoots out of a rocket, mistakes are made along the way. We see that it is going to take a while for this industry to mature and stabilise.

“We do not currently have the actuarial data or claims data, or even the rating data for what carriers should be charging for premiums. They effectively just throw something against the wall and see if there is a buyer.”

With this in mind, a separate US insurance market and rate report for cannabis by HUB International identifies that, going into 2022, the cannabis insurance industry is likely to see the continuation of an extensive underwriting process, for example, applications will request projected annual revenues, which will then be used to develop premiums.

Rahn adds: “While some market participants have done well in the directors’ and officers’ (D&O) market niche, others have paid out large claims in 2019 and 2020. The current premiums for D&O insurance have raised the cost of entry into the cannabis industry. That is what happens in a hard market, and that is when people turn to captives.”

### High stakes? Use a captive

There exists, therefore, significant interest in cannabis companies looking for alternative approaches to address their insurance needs. Captives present a promising way to solve these challenges as an innovative industry that is willing to take on risks where traditional commercial cover is reluctant, or simply refuses to do so. The majority of cannabis businesses initially set up captives for D&O liability coverage owing to practicalities in the market. This is observed by Patrick Ferguson, Canadian captive and global life reinsurance sales leader at Marsh Canada. He identifies: “Initially, a lot of the work that we did here in Canada was around cannabis companies looking for D&O coverage.

“The marketplace just did not have any capacity, and premium rates were so high, that these companies were looking for alternatives. We were able to set up captives for them in jurisdictions like Bermuda, which allows cannabis captives, provided the insurance is federally legal in the jurisdictions where the insurance is being offered.”

This initial trend is affirmed by Kim Willey, partner at ASW Law. She adds: “A Bermuda captive offers a fully-contained corporate vehicle, which may be set up quickly to mitigate enterprise risk and manage insurance costs in a jurisdiction that is well-versed in captive insurance programmes.”

Now, the cannabis captive market is seeing the expanded use of captives for a greater variety of risks, such as property, general commercial liability, product liability, environmental liability, crop and workers’ compensation.

Willey explains: “As the industry matures and cannabis companies become more familiar with the captive structure, we see captives being used for a broader range of risks, including general liability, property and product risk — such as vaping, which is difficult to insure in the commercial market.”

This evolution is facilitated because captives offer advantages when insuring the cannabis industry compared to other self-insurance structures, according to Petrilli. He highlights the inherent control, transparency and accessibility offered by captives, while organisations such as NCRMA and Trichome (the association’s captive-based model that administers risk protection and insurance products) provide enforcement, control and risk management at the captive core.

Examining the advantages of captives, Ferguson adds: “When you think of self-insurance, the first stopping point is the idea that, a lot of times, self-insuring just means not buying insurance and keeping the risk on your corporate balance sheet.

“Where a captive can provide value in addition to that is in providing an overall governance structure around insuring those risks. So instead of just having the risk on your balance sheet and not buying insurance, you set up a captive insurance company, pay a premium to that captive, and fund accordingly relative to the risk that it is taking.”

### Regulation

The interest in Bermuda captives for cannabis companies is primarily attributable to the Bermuda Monetary Authority’s (BMA) notice in November 2019 that it would not object to BMA-supervised entities conducting business with licensed cannabis cultivators, processors or sellers — providing the operations are not contrary to any offences provided for in the laws of a foreign jurisdiction.

This means that cannabis businesses that are federally legal in the jurisdiction in which they operate (for example, Canada) are eligible to set up a captive insurer licensed by the BMA.

In addition, Willey explains that since Bermuda captives are classed as non-commercial insurers, they are not subject to the full Solvency II-equivalent regulation. This means that setting up a Bermuda captive is an efficient option for self-insurance.

Willey adds: “Regulation is very important when considering a self-insurance structure. The BMA was at the forefront globally in confirming that cannabis companies with federally legal operations may set up Bermuda insurance vehicles.”

## Joint control

*The US currently has two key proposed pieces of legislation which, if passed, have the potential to make traditional financial resources more accessible to cannabis operations:*

### **The Safe and Fair Enforcement Banking Act**

(SAFE Act) aims to protect banks and financial institutions that service cannabis-related businesses in states where use is legalised for medical or recreational purposes. As a Schedule I controlled substance by the US Drug Enforcement Agency, banks face penalties from federal regulators for serving legitimate businesses in states where cannabis use is legalised owing to the lack of harmonisation between federal and state law. Therefore, many of these businesses are forced to use a cash-only model which makes them highly vulnerable to theft, fraud and violent crime.

Under the SAFE Act, federal regulators would be explicitly prohibited from distributing these penalties, which means that legitimate cannabis businesses could operate under a safer, more trustworthy model.

### **The Clarifying Law Around Insurance of Marijuana Act**

(CLAIM Act) aims to open the insurance market to more competition, as well as offer greater capacity, assist lower premiums, and encourage new markets for hard-to-place risks. It will also protect ancillary businesses to the cannabis industry, such as landlords, technology vendors, legal, accounting and design professionals, who will be able to continue providing products and services without the fear of losing their insurance.

The CLAIM Act would prohibit penalties for insurers that provide coverage to a state-sanctioned and regulated cannabis business, as well as the termination or limitation of an insurer's policies on the basis they have engaged with a cannabis-related business.

However, this is considerably more challenging for US-based businesses looking to operate on a national or international basis.

Rahn notes that the restrictions from a federal standpoint mean insurance brokers have a multitude of concerns, beginning with identifying the states that will accept cannabis risk.

“We also have to look at various departments of insurance, the Internal Revenue Service and the Drug Enforcement Administration to determine their stance on cannabis companies. Our clients are mostly Canadian public companies with US operations, which then presents cross-border issues,” he adds.

Although regulation is generally considered to be a hindrance in this federal respect, with the lack of harmonisation between state and federal law presents practical and legal challenges, Ferguson adds that regulation can be helpful.

He explains: “A captive being a regulated insurance entity provides a lot of braces and various rules around how it operates. It gives a sphere of regulation around how the captive is run, which clients find beneficial relative to how they are insuring risk versus simply keeping it on the corporate balance sheet.”

## Time to be blunt

Legal restrictions at a federal level remain a significant challenge in providing insurance coverage for the US cannabis industry. It is expected that even the provisions of the SAFE Act will not fully address the problem of high commercial insurance prices owing to the limited loss history of the emerging cannabis market.

At present, banks are a significant problem for the cannabis industry as a whole, because few banks will openly handle cannabis money. Petrilli of NCRMA explains that this is a result of misconceptions around the reputation of the cannabis industry, as well as an outdated federal mandate.

“We must find ways to get around this statute and form a solution to the banking problem to open up a larger floor. This external non-operational risk arising from banks and other non-operational sources affects capacity, which then makes it difficult to determine the risk management side of cannabis operations, as companies

have to mitigate both the internal (cannabis) risk and the external (litigation) risk.”

This challenge is affirmed by Marsh’s Ferguson. He explains: “The federally legal aspect of cannabis is really the biggest challenge for a variety of reasons, as it really closes the door on the captive solution for a lot of clients.”

He adds that another significant challenge facing the cannabis industry is reduced capacity, as only certain markets will write to cannabis companies that have insurance in a non-federally legal jurisdiction.

“The hope from our perspective with this challenge is that the US in particular will choose to federally legalise recreational cannabis, because that would provide a new window of opportunity for getting coverage for these companies, not just in captives, but in general.”

Outside of regulation, the cannabis industry faces specific challenges as outdoor cultivators are especially vulnerable to weather risk, particularly in the context of climate change-related natural disasters and extreme weather events. Securing crop insurance has traditionally been difficult for growers, on top of which persistent severe weather creates catastrophe risk.

On the other hand, indoor growers that rely on an IT infrastructure are susceptible to cybercrime as a top manufacturing risk during the extraction process. For example, a ransomware attack could target air conditioning controls or a carbon dioxide feed that must be set at exact levels for optimal crop growth.

There is also a significant liability concern if a cyberattack affects product labelling — the issues here go beyond business interruption and loss of revenue. Overall, cannabis businesses are particularly vulnerable to so-called ‘bad actors’ owing to their cash reserves and often weak IT infrastructures. In addition, the extraction process involves hazardous and explosive chemicals that cause high insurance premiums.

The industry as a whole is attempting to reduce the use of dangerous chemicals, but lacks the technology to eliminate the use of solvents (such as butane, propane, ethanol and carbon dioxide), which pose a significant health risk for both workers and consumers.

## As the smoke clears

In order for the cannabis industry to overcome these underlying challenges it must address the barriers to business growth in innovative ways.

For example, parametric insurance presents a possible solution for outdoor growers and crop risk as the model would pay out in full when a weather element reaches a certain threshold, regardless of actual damage.

Looking to the next 12 months, Alternative Risk Strategies’ Rahn anticipates little change in the landscape of cannabis captives outside of further increasing premiums and restricted capacity. He notes that most D&O capacity in cannabis is gone by June, leaving market participants essentially “fighting over the same scraps”.

He adds: “I do not think we will see anything drastic until the SAFE Act, or until cannabis is no longer federally illegal. This will allow banks, insurance companies and institutional investors to come into the industry to provide the much-needed capital, both on the reinsurance side and on the primary side.

“It has been and continues to be an interesting ride — you must take the long view here. In the short-term, I think cannabis will continue to be state-regulated and free from any federal restrictions. It is going to be interesting to see how states react to open market pricing to compete for the supply and demand of cannabis.”

With the current market conditions set to continue for the foreseeable future, Willey expects a continued interest in the Bermuda captive model, while Petrilli anticipates increased risk-bearing capacity through captives, as well as a greater need for custom coverages to meet state and municipal regulations, and a growing sustainability agenda driven by insurance with risk management at its core.

Ferguson concludes: “The whole idea of captives in the cannabis industry is evolving. There is a lot of depth and range for additional solutions to the cannabis industry with captives, and we are really at the beginning of this evolution with cannabis companies looking at captives. I think we are going to see a lot of interesting things happening in the next few years.”



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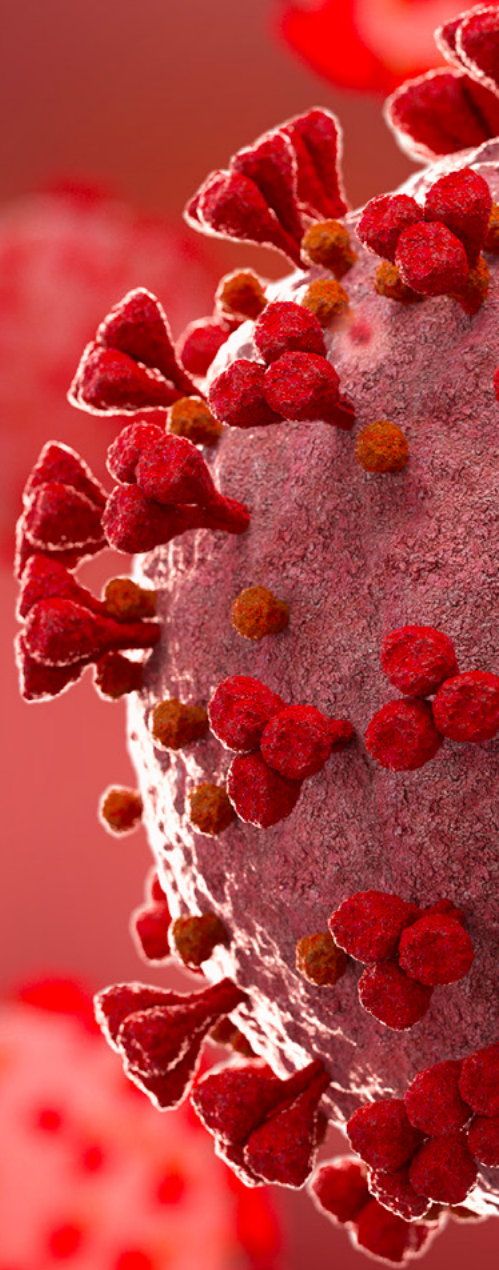


*Own Your Outcomes*



# Pardon the interruption

**Nick Gurgone of Pinnacle Actuarial Resources  
and Grant Maxwell of Allianz Global Corporate &  
Specialty talk to Rebecca Delaney about the impact  
of the COVID-19 pandemic on the demand for  
business interruption insurance through captives**





Ranked as the number two risk globally in Aon's 2021 Global Risk Management Survey, business interruption (BI) has exploded as a hot topic on any insurance and risk manager's priority list over the last few years. As well as highlighting the increasing importance of being able to manage long-tail risks, the COVID-19 pandemic has demonstrated how the interconnectivity of risk means that BI can affect multiple industries and companies simultaneously. During the pandemic, companies were forced to adapt quickly to a virtual world, while increasingly inconsistent government regulations had a significant impact on business continuity plans and the supply chain. From a BI perspective, therefore, resilience is absolutely critical within an organisation.

No longer regarded as a linear risk, the responsibility for resilience and risk transfer has shifted from insurance buyers to risk management teams as their organisation's visibility in BI and people risk heightens. BI issues can also arise from cyber risk, as the evolving type, volume and success of cyber-attacks has elevated this threat to both an operating risk and an underwriting risk. Airmic's annual survey names BI following a cyber event as the top front-of-mind risk for risk professionals, which is indicative of the dramatic acceleration in rate increases for cyber insurance.

Grant Maxwell, global head of alternative risk transfer at Allianz Global Corporate & Specialty (AGCS), says: "For most organisations, the biggest fear is not being able to produce and deliver their products or services. BI events can have a very costly and long-lasting impact that can extend well beyond an individual organisation."

This has created a definitive trend of companies looking to insure against BI. Nick Gurgone, consulting actuary at Pinnacle Actuarial Resources, explains that BI insurance reimburses companies for the lost profits and extra expenses that may be incurred as a result of a BI incident or trigger.

He adds: "A key component of BI policies is how the triggers are defined. Traditionally, the primary BI coverage offered by the commercial insurance market has been for property damage only, included as a piece of the commercial property policy, but does not cover BI resulting from causes other than a property loss — in other words, underlying events causing BI must be covered triggers in the policy in order for the interruption to be covered in the policy."

Therefore, companies have been seeking to cover a larger amount of triggers as organisations continue to face major world events — such as catastrophic weather events, recessions and the COVID-19 pandemic — that cause BI but are not covered in many commercial policies. Maxwell adds that companies are also experiencing heightened exposure to other unique, non-physical — but nonetheless disruptive — BI events, such as supply chain disruption, loss of key employees, loss of key contracts or customers, reputational damage, cyber risk and labour shortage.

Companies are striving for a more comprehensive awareness of their exposure to these personalised, unique risks that have the potential to cause BI. Gurgone explains this is a result of the growth of enterprise risk management and critical thinking around the planning and managing of risk.

Collectively, these trends have acted as significant drivers for demand and creativity for non-traditional BI coverages. Maxwell notes: “As business becomes more connected, digital and globalised, these non-physical risks are proliferating and companies are increasingly looking to insure against them.”

From a risk management perspective, focus has shifted to risk assessment training to identify business continuity opportunities. Organisations, and particularly the captive industry, thrive on innovation and creativity — there is an opportunity in the increased knowledge surrounding risk to improve risk management strategies and explore potential cost savings.

Gurgone explains that, since BI insurance for certain risks is scarce and often expensive in the commercial market, captives have “effectively become the primary market” for such coverages. For example, small- and medium-sized companies can participate in a quota share arrangement with a reinsurance captive that assumes the majority of risk from several similar captives.

He adds: “The captive approach in general also carries the benefit of being able to craft insurance products to meet the needs of an insured, as long as the policies meet the definitions of insurance, and the risk is insurable.”

The advantages of utilising captives to protect an organisation from BI is affirmed by AGCS’ Maxwell. He notes that since many companies are looking to self-retain a larger share of their BI

exposures, those that own a captive and have a holistic risk management approach, are able to absorb some of these risks in their captive.

“As well as an effective form of risk financing, this can mean more focus on the risk to quantify and transfer it internally, which may result in more active and advanced risk management,” Maxwell explains.

In addition, companies with captives or higher self-retentions are able to access higher capacities in the traditional insurance market, as well as form a better understanding of their own risks to develop an advanced approach to risk management.

“Using the captive may allow diversification with other risks that are ceded to the captive. Combined with a structured reinsurance solution behind a captive, a company has a much better grip on reducing and managing the volatility that is inherent to such BI risk in a capital-efficient manner.”

## Challenges

As with any form of self-insurance, providing BI insurance presents challenges. Maxwell points out that, although property and BI insurance is a traditional insurance product, it is a highly sophisticated one. Assessment of BI risks and identification of the most urgent BI scenarios is a complex process, exacerbated by the frequency of disruptive events and global interconnectedness of production and supply chains. With this globalised perspective in mind, insurers must carefully manage any potential aggregation in their portfolios, as single events, such as natural catastrophes, can cause business and supply chain interruption for multiple companies, causing multiple claims from policyholders globally.

Maxwell adds that greater awareness of risk brings the realisation that not all BI risks are easy to insure and to find meaningful capacities, particularly for large and contingent BI risks. This means there is a lack of transparency, which generates uncertainty, around the realistic BI exposure of an organisation after specific events.

“The better the transparency and data, the more meaningful capacity insurers are able to provide,” Maxwell summarises. “We still see clients whose mapping of supply chain risk is not as detailed as it

should be. It is critical to understand the value chain and identify the most important exposures in order to mitigate the risks and create solutions to transfer or reduce the risk.”

## Full steam ahead

Despite these challenges pertinent in providing BI coverage, the road ahead for the captive industry looks optimistic. Spurred by the COVID-19 pandemic, the unprecedented level of BI over the last two years has inspired companies, brokers and insurers to examine how they can manage this risk more effectively and proactively.

AGCS' Maxwell affirms: “There is now a desire and willingness among top management to bring greater transparency to supply chains and to work with data to better understand the risks. Momentum has been building and increasingly businesses see resilience as a competitive advantage.

He adds that with this increased focus, the next 12 months is likely to see new developments in risk assessment, risk mitigation, risk retention and risk transfer, with the latter increasingly leveraging a combination of traditional insurance products and alternative risk transfer solutions and captive involvement.

In addition to growing demand for BI coverage, the captive market is likely to see an increasing list of triggers that companies are interested in insuring, adds Pinnacle's Gurgone.

He explains: “Many more companies will have a newfound interest and awareness of these types of risks, and demand for related coverages will increase, especially from the captive market, which is currently the primary market for most of these risks.”

Captive managers in charge of reinsurance programmes that impact multiple captives will have fluctuating responses to this charge in demand, Gurgone anticipates. While some may offer more BI coverages that explicitly include pandemic risk, others will not want to risk solvency to their reinsurance pools.

“Overall, it seems likely that the captive industry will continue to be the primary market of non-property BI, and that general demand for this insurance will continue to increase,” he concludes. ■

## Beware the pitfalls

*Pinnacle's Gurgone outlines two major challenges in providing BI insurance:*

**Appropriately defining the coverage** — in order for a BI risk to be insurable, there are some key requirements. Fundamentally, it must be possible to calculate what a BI loss is when one has occurred, which can be a tricky process. In addition, the risk of loss must exist and result from a fortuitous event.

A timely example is the challenge of defining a BI coverage trigger for pandemic. Can COVID-19 BI losses be covered on a go-forward basis when COVID-19 is an event that is already occurring? In other words, would losses stemming from the pandemic be fortuitous at this point? It is important to word the policy language so that a loss is only covered if something fortuitous and unknown occurs after the effective date of the policy date.

**Determining an actuarially-sound premium** — while common pricing approaches for traditional coverages rely heavily on databases of claims and exposures large enough to have acceptable statistical credibility, past BI losses, or the lack thereof, do not tend to correlate with or be as predictive of future losses to the extent of traditional coverages.

Consequently, analysing historical claims is not nearly as useful for determining an actuarially-sound premium for BI coverages. Actuaries need to turn to less traditional and more creative ratemaking techniques. Another actuarial challenge is that policy language tends to be more unique and personalised with BI coverages than with traditional coverages. Policies with the same name might not cover the same exposures or have the same exclusions, so the actuary may not be able to build a one-size-fits-all pricing model for their BI rating.



# The Grand Domicile

**In the aftermath of the COVID-19 pandemic and amid reviews of European directives on anti-tax avoidance, PwC Luxembourg discusses the outlook for the captive insurance industry in Luxembourg**

Although one of the smallest sovereign states in Europe, Luxembourg can lay claim to an impressive résumé as a founding member of several leading European and international organisations, including the European Union, the Organisation for Economic Cooperation and Development, the United Nations and the North Atlantic Treaty Organization.

Internationally renowned as a reinsurance hub, Luxembourg is well-positioned as the largest captive reinsurance domicile in the EU. A market segment report by A.M Best last year determined that the captive sector in Europe continued to thrive in hardening market

conditions, with European captives demonstrating resilience to the effects of the COVID-19 pandemic.

As companies evaluate the economic rationale for owning and operating a captive in light of directives aimed at anti-tax avoidance and profit shifting, what does this mean for the Grand Duchy?

Partner Géraud de Borman and manager Afif Hamdi of PwC Luxembourg talk to Rebecca Delaney about the landscape of the captive insurance and reinsurance market in Luxembourg, as well as challenges on the horizon.

### **How do you assess current market conditions for the captive insurance and reinsurance industry in Luxembourg? What trends are you seeing?**

Over the last few years, we have been witness to an increase in insurance costs. The pressure on the supply is high and cannot face the demand. Therefore, multinational groups are continuously considering different solutions to insure or reinsure risks at group level that traditional market players can no longer secure.

Naturally, captives have emerged as an alternative solution, either at company level or for pooling several group companies' risks in the same captive. The broadening of the exposure spectrum of groups, notably with respect to cyber, climate, consumer protection and pandemic risks, have made insurance and reinsurance captives more attractive to multinational groups.

Within the above context, the current market conditions are conducive for the implementation of a captive. In particular, as a pioneer in Europe, in terms of insurance and reinsurance captives, Luxembourg offers an innovative environment both from a regulatory and tax perspective.

### **How is the regulatory environment of Luxembourg beneficial for captive owners?**

Luxembourg implemented a robust and modern legal and regulatory framework for insurance and reinsurance captive vehicles, which are under the supervision of a dedicated regulator, the Commissariat aux Assurances (CAA).

In addition, Luxembourg was a historical frontrunner in the transposition of the 2005 European Reinsurance Directive.

This established the single passport within the EU, allowing a captive under the supervision of its member state of origin to cover risks within the EU without having to apply to other member states for a licence. Indeed, Luxembourg policymakers have played a pioneering role in Europe with respect to captives.

Through their strong understanding of the way captives function, Luxembourg's policymakers participate in the development of the future European framework for captives, notably in advocating

***“Captive owners in Luxembourg will benefit from a historical knowledge of the speciality of the captive model, managed by the CAA”***

**Géraud de Borman**, partner, PwC Luxembourg

for the recognition of an adapted treatment with Solvency II for captives. In this respect, captive owners in Luxembourg will benefit from a historical knowledge of the speciality of the captive model, managed by the CAA.

We are also seeing that the European regulatory constraints on captives appear to be easing.

The review of the Solvency II directive aims to provide more simplifications and proportionality on captives, underlining the support of the European community in the development of captives in the EU that aim to reduce reporting costs and administrative burdens.

### **What are the most significant challenges facing the captive industry, in Luxembourg and as a whole?**

Even though the accelerating interest in captives can be explained by a number of reasons — including, among others, the disengagement of traditional insurers regarding certain risks, their degree of exposure compared to certain groups, the broadening of

***“The increasing need and interest in captives have been well considered by the EU Commission in the draft proposal of amending the Solvency II directive”***

**Afif Hamdi**, manager, PwC Luxembourg

the risk profile of multinational groups and significant fee increases — the captive industry still faces several challenges.

The main challenges are the broad diversity and complexity of risks captives need to insure or reinsure.

The complexity of the risks (including cyber, climate and political risks) requires captives to properly understand them, as well as the exposure of the group, in order to accurately catch the underlying risk.

Additionally, the diversity of multinational groups, as well as their specific operating model, requires captives to be fully adaptable to their business activities and determine their risk profile, which adds another level of complexity.

Lately, we have also seen an increasing number of international groups restructuring their operations. As a result, risks are also moving from one country to another, which may be more complex for captives.

Furthermore, in a fast-changing tax environment determined to tackle abusive practices, new European directives may impact the captive industry.

Recently, the European Commission issued two proposals of directives aimed at preventing the misuse of shell companies with no or minimal substance and economic activity (Anti-Tax Avoidance Directive III) and ensuring a global minimum level of taxation of at least 15 per cent for multinational groups in the EU (International Tax Pillar II), whose potential impact on captives may be considered.

### **How do you expect the landscape of the captive industry in Luxembourg to develop in 2022?**

As the market trends show, for the past few years captives have experienced a resurgence of interest.

The number of captives has risen sharply in recent times, reflecting that they are not only used by large multinational groups, but also by a wide range of entities such as non-profit organisations.

The increasing need and interest in captives have been well considered by the EU Commission in the draft proposal of amending the Solvency II directive as dated 22 September 2021, notably ensuring that insurance and reinsurance captives should benefit from the proportionality measures when classified as low-risk profile undertakings.

The tax treatment — in particular, the Luxembourg tax treatment with respect to the deferred tax regime allocated to the equalisation provisions — seems to be better understood by foreign tax authorities.

Questions regarding substance and governance remain a hot topic for tax authorities, and transfer pricing considerations should be analysed more deeply by tax authorities.

Finally, in terms of data, almost 200 reinsurance undertakings are operating in Luxembourg as of year-end 2020.

We have seen a significant increase of this number in 2021 and we are expecting an increase in 2022. In this respect, and within the aforementioned context, we may reasonably expect that the interest in captives will continue to grow in the years to come and Luxembourg will remain one of the main locations within the EU. ■





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### **Diana Hardy selected chair of NCCIA**

Audit partner Diana Hardy has been selected as chair of the North Carolina Captive Insurance Association (NCCIA), effective 2 May.

In addition to her new role with NCCIA, Hardy is a member of the North Carolina Association of Certified Public Accountants and the Association of Certified Fraud Examiners.

Based in Raleigh, North Carolina, Hardy is an audit manager at RH CPAs, a role she has held since 2015.

Hardy previously served at Thomas, Judy and Tucker, a Raleigh-based accounting firm from May 2008 to 2015. During her time at the firm, Hardy held several positions, most recently as senior audit associate. ■

### **WTW has appointed Lawrence Bird as director of captive and insurance management operations for Asia Pacific.**

Based in Singapore, he will report to Peter Carter, head of WTW's global captive practice. WTW's captive practice offers a range of alternative risk solutions, including captive feasibility studies, captive implementation, ongoing ancillary insurance operational services, and strategic reviews.

Bird brings a wealth of insurance experience to the role, having previously served at Marsh Management Services (Bermuda) for more than 25 years, as managing director and head of office.

### **PMA Companies has appointed Steven Woodard as captives and programmes leader within the firm's specialty markets division.**

The insurance company administers single-parent captive programmes and workers' compensation group programmes to alternative risk clients and brokers.

In his new role, Woodard will be responsible for the implementation and oversight of new captive formations, as well as coordinating the service of existing alternative market clients by collaborating with business partners and stakeholders.

Woodard previously served as director of alternative markets at ProSight Specialty Insurance. Before this, he was assistant vice president of property and casualty underwriting at Lockton Affinity, and underwriting and profit centre

manager at Zurich Insurance North America respectively.

Commenting on LinkedIn, Woodard says: “I absolutely cannot wait to begin contributing to the positive growth and results within this organisation while I continue to flourish and develop professionally during this next phase of my career.”

Elsewhere, Chris Kramer has been appointed national sales executive within PMA Companies’ specialty markets division.

In this role, he will be responsible for driving the profitable growth of new captive and group opportunities, as

well as consolidating relationships with existing clients.

Kramer has more than 35 years’ experience in the property, casualty and alternative risk financing industry. He most recently served as managing director of Green Mountain Sponsored Captive Company, Vermont’s largest independently-owned rental captive.

Other previous roles include senior vice president at Caitlin Morgan Captive Services, director of marketing for captive insurance programmes at Ullico Casualty Group, and senior vice president at Atlas Insurance Management.

**The Vermont Captive Insurance Association (VCIA) has appointed Kevin Mead as president.**

He succeeds Richard Smith, who resigned in October 2021 after holding the position at the largest captive membership association for 12 years.

Mead previously served as executive director of a rare disease foundation, the International Pemphigus Pemphigoid Foundation, and vice president of resource development for Spokane County United Way. Before this, he was CEO of PrimeGlobal, having overseen its formation through

The advertisement features a dark blue background with a subtle geometric pattern. At the top center is the PMA Companies logo, which consists of a circle of white stars surrounding the text "PMA COMPANIES" in a white serif font. Below the logo, the main headline "Our Captive Division is Hiring." is written in a large, white, sans-serif font. Underneath the headline, the website address "PMACOMPANIES.COM/CAPTIVES/CAREERS" is displayed in a smaller, white, all-caps sans-serif font. A short paragraph of text follows, stating: "With more than 100 years of experience, we are a trusted leader and recognized expert in commercial risk management insurance solutions and services." In the bottom right corner, there is a small circular logo for Old Republic Insurance Group, featuring a stylized 'R' and 'O' inside a circle, followed by the text "OLD REPUBLIC INSURANCE GROUP" in a white sans-serif font.

the merger of three global independent accounting associations.

In his new role, Mead brings extensive experience in association management and financial strategy, making him well-positioned to support VCIA's annual conference, increase membership, and evolve the association as a whole.

VCIA board chair Andrew Baillie comments: "We are thrilled to have found someone whose experience and approach perfectly aligns to the continued development of VCIA as it represents and promotes the interests of its members. We are confident that Kevin's broad experience will be very complementary to that of the experienced staff of VCIA."

**Aon has appointed Graham McCarthy as director of client services, captive management and risk advisory, based in Dublin.**

As a leading European captive domicile, Aon's captive and insurance management practice in Dublin offers actuarial, management and risk consulting services to insurance and reinsurance companies, as well as captive facilities, across a variety of industries and geographies.

McCarthy previously spent more than six years at WTW Management (Dublin), where he held the positions of executive director and account director.

Before this, he served as captive insurance manager at Aon Insurance Managers (Dublin) and captive underwriting manager at Willis Management (Gibraltar) respectively.

Commenting on his appointment via LinkedIn, McCarthy says: "After six enjoyable and successful years at WTW, I am pleased to share my news that I have rejoined Aon and will remain in the captive management and risk consulting space.

"I would like to thank everybody at WTW for their support, opportunities, and progression over the years. I am excited to be part of Aon's fantastic client-centric approach and to hone best-in-class advisory services."

Elsewhere, Sven Roelandt was appointed global leader of captive employee benefits services. In his new role in Aon's newly-created global team, Roelandt will be responsible for delivering bespoke services and support in the reinsurance space to captives with employee benefits risk.

Roelandt previously held the position of global expert in employee benefits financing strategies and carrier relations at Aon.

Before this, he served as regional manager for Western Europe, the Middle East and Africa at Generali Employee Benefits, where he began his career as a business specialist in employee benefits.

**Property, casualty, accident and health insurance solutions provider Crum & Forster has appointed Mark Coyle as assistant vice president of captives.**

The firm's accident and health division administers a range of insurance and reinsurance products, including medical stop-loss (specific and aggregate), travel, occupational risk and other speciality risk.

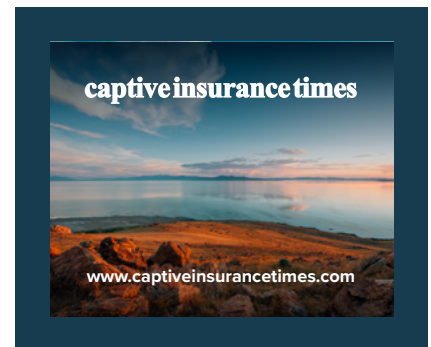
Crum & Forster provides international solutions through its wholly-owned captive facility, which enables, among other services, flexibility and customised reinsurance solutions.

In his new role, Coyle will be responsible for assisting the development and expansion of Crum & Forster's fronting and captive solutions business through the implementation of proven programmes, as well as exploring new complex risk mitigation requirements.

Coyle has held a variety of roles at Crum & Forster, spanning almost a decade. This includes assistant vice president of underwriting, executive underwriter, and senior underwriter for risk management casualty.

Before Crum & Forster, he served as senior underwriter for middle-markets at Liberty Mutual, before which he was underwriter for middle-markets at Zurich Insurance.

David Kaplan, vice president, captives and gig economy, Crum & Forster, says: "I am very excited to have Mark join the team. He is a solid underwriter who possesses a strong background in property and casualty coverages." ■





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# GENERALI

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## Employee benefits. We have the solutions.

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A Network of over 120 world-class local insurance partners, covering more than 100 countries and territories around the globe.

A high-degree of flexibility to meet the group insurance and pension needs of multinational corporations wherever they operate.

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The security and stability of the Generali Group, one of the world's leading insurance and financial players.

Along with the traditional multinational pooling options, the GEB Network is leader in Reinsurance to Captive and offers innovative, cost-efficient multinational pension solutions.