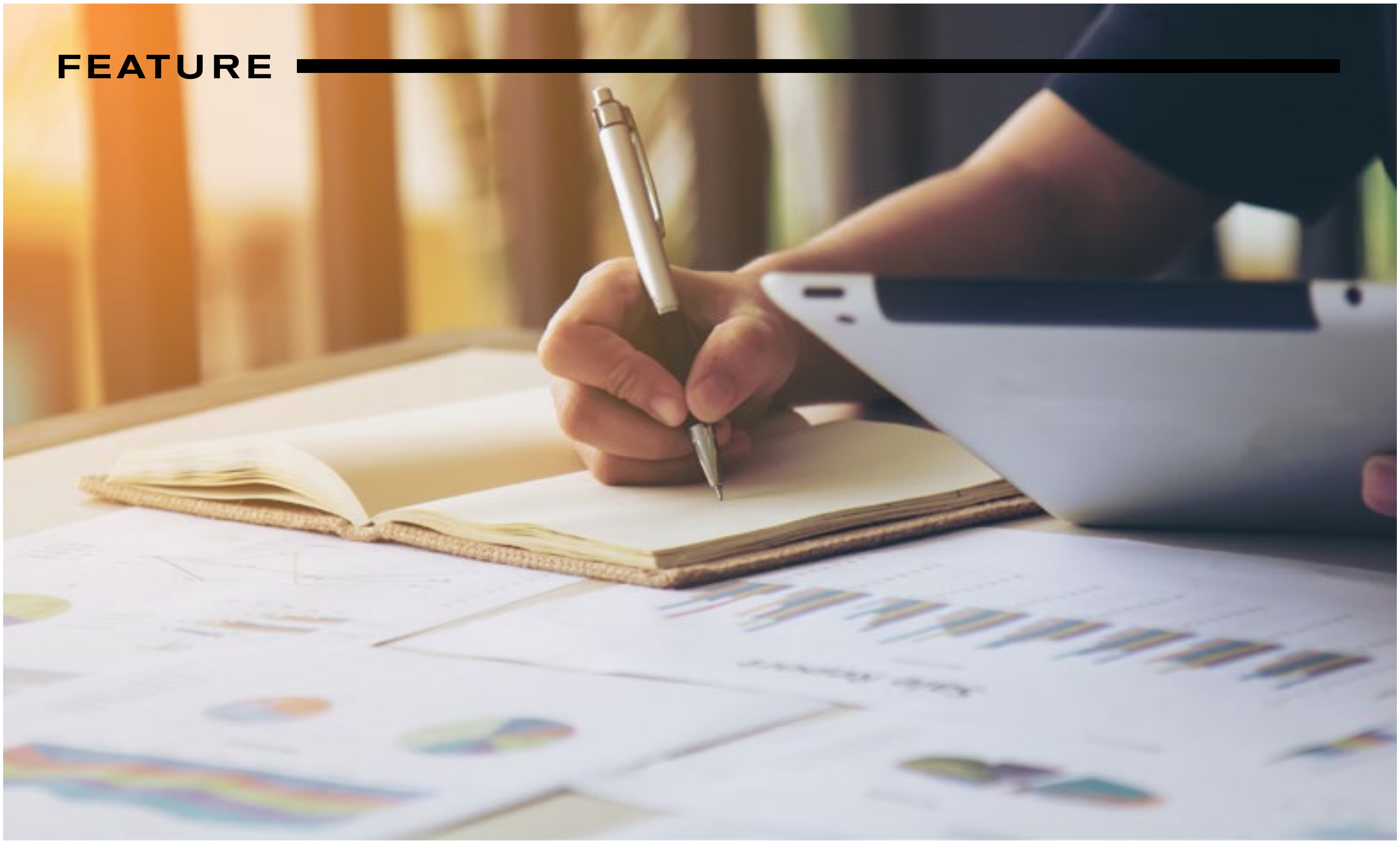
FEATURE



Written By Karrie Hyatt

# CAPTIVE ACTUARIES IN THE TIME OF THE PANDEMIC

The COVID-19 pandemic has created unprecedented times for the actuarial field. As a field that relies heavily on historical data, the pandemic has created a new dynamic for actuaries working with captive insurance companies.

When it became evident that COVID-19 would cause a widespread pandemic, George M. Belokas, vice president and actuary with GPW and Associates, Inc., thought, "Like most, my initial reaction to the pandemic was fear for the health and safety of my family, friends, colleagues, and clients. It became more evident that our clients would be negatively impacted when state governments began to mandate business closures and institute 'stay at home' orders."


Robert Walling, principal and consulting actuary with Pinnacle Actuarial Resources, Inc., thought that everything would become a bigger challenge this year. "It hasn't disappointed. It doesn't matter if we're doing pricing studies, reserving studies, or new formation feasibility studies; it doesn't matter what line of business we're working on, COVID comes up in the first five minutes in any client discussion."

Al Rhodes, president and senior actuary, SIGMA Actuarial Consulting Group, Inc., had similar thoughts. "Initially my thoughts were focused on all of the challenges related to the management and evaluation of risk. We work for a wide range of clients of various sizes and in various industries. The pandemic does not affect each client the same way and some face new and emerging risks."

"At the beginning of the pandemic," Rhodes continued, "SIGMA put together some educational articles for clients about specific analytics that are helpful in determining early trends in unique client data. While immature data may be inconsistent, analytics can still provide valuable insights when analyzing early trends. Claim lag analytics and reviewing loss development trends at more frequent intervals, even quarterly, may be particularly useful."

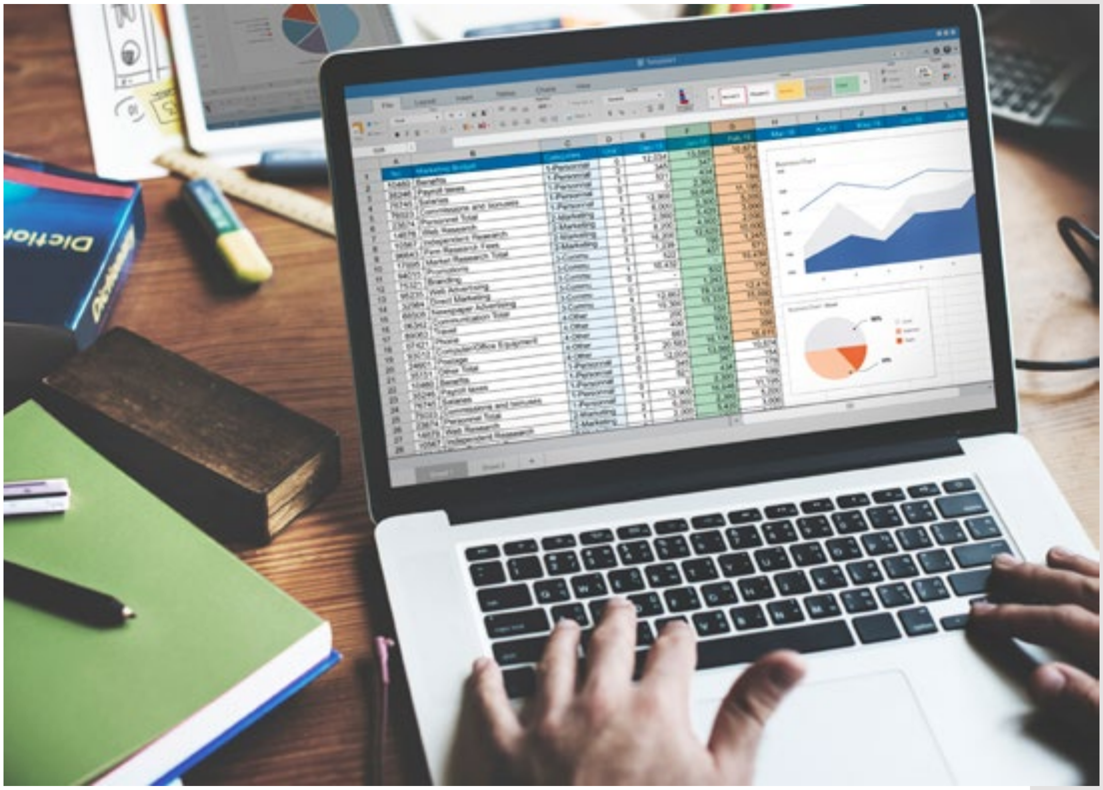
For Belokas, "We anticipated the direct impact of business interruption losses resulting from the mandates but it took longer to realize the indirect impacts. Examples of indirect impacts include the reduction in health insurance utilization when elective procedures were not allowed, the impact of changes in driving habits due to school closures and businesses shifting to a remote workforce, and the liability businesses may incur resulting from their actions (or inactions) to slow or limit the spread of COVID-19. As we enter a new wave of cases, the full impact of the pandemic is not yet known."

Actuaries deal in historical data. The pandemic created a whole new playing field with all new data. According to Walling, "There isn't a great historical precedence here because of the way it affects differently individual industries and even individual companies within an industry. There is no one COVID-19 benchmark that is going to apply to every nursing home, trucking company, or janitorial service company. There is just not any universal solution that applies to every circumstance an actuary is going to come across."

As the captive industry is seeing a surge in growth, actuaries are staying busy right through the pandemic. With the hard market, companies are turning to captives to cover traditional risks, as well as new or underdeveloped risks that have been triggered by COVID-19.

"The commercial insurance market is hardening," said Belokas. "Couple that with the commercial insurance carriers' refusal to cover pandemic losses and the result is a significant increase in interest for captive insurance and other alternative risk management programs. Actuaries in the captive insurance industry are extremely busy assisting in the development of new captive programs and analyzing the impact of COVID-19 and potential future pandemics on existing captive insurance programs."

According to Rhodes, "Many companies are seeking to fund more traditional risks in a captive because pricing is so high compared to prior renewals. We are seeing particular interest in property, automobile and general liability, and directors and officers liability. In the non-traditional risk area, we are continuing to see increases in emerging risks as well. Specifically, we've seen more interest in what is defined as reputational risk or possibly crisis management risk. That's becoming more of an issue with companies operating through video conferencing and is a great example of something companies didn't have to worry about at the beginning of the year."



## LOOKING AT THE DATA

Historical data is limited for many captives even without a pandemic. When data is limited, actuaries have to dig deep into the data that is available.

According to Belokas, "As an actuary in this field, we commonly find ourselves asked to analyze risks with little or no historical data. I find it helpful to begin the analysis by asking a few basic questions. What types of events would trigger a loss under the terms of the policy and how is the amount of loss determined. For example, if a captive wrote a policy covering 'pandemic business interruption,' how would the policy define a 'pandemic'? Would a slow-down in customer activity trigger coverage or does the policy require a mandated closure of the insured business? Answers to these types of questions are critical to understanding a risk and developing a model that appropriately reflects the frequency and severity of a covered loss."

For Rhodes and SIGMA, this requires working closely with their client to garner qualitative data that can supplement any quantitative data. "We take several approaches when data is limited. One approach is to focus on risk quantification through discussion and review of relevant internal data; even if that data does not look like a traditional loss run."

The company works with client management to get qualitative feedback for anticipated frequency and severity of risks. SIGMA then researches and identifies industry-specific data that is relevant. "Finally, we consider prior market quotes, if available, for a risk. All of these can supplement the more traditional historical data, even if significantly limited."

When faced with lack of historical data, Walling says that there is no substitute for looking into the data on a more granular basis. "A lot of it is looking at the data in a little more detail. For example, we're looking at a workers' comp program over the last year to differentiate between the COVID-related workers' comp claims and the non-COVID claims. What we're finding is that the workers' comp claims are much smaller than the typical claim and they tend to have a much shorter duration. Looking at the data on a more granular level allows us to do a better job of isolating the impact that COVID is having."

Rhodes suggests looking at data on a more frequent basis. Generally, for captives, actuaries look at the year-end data.

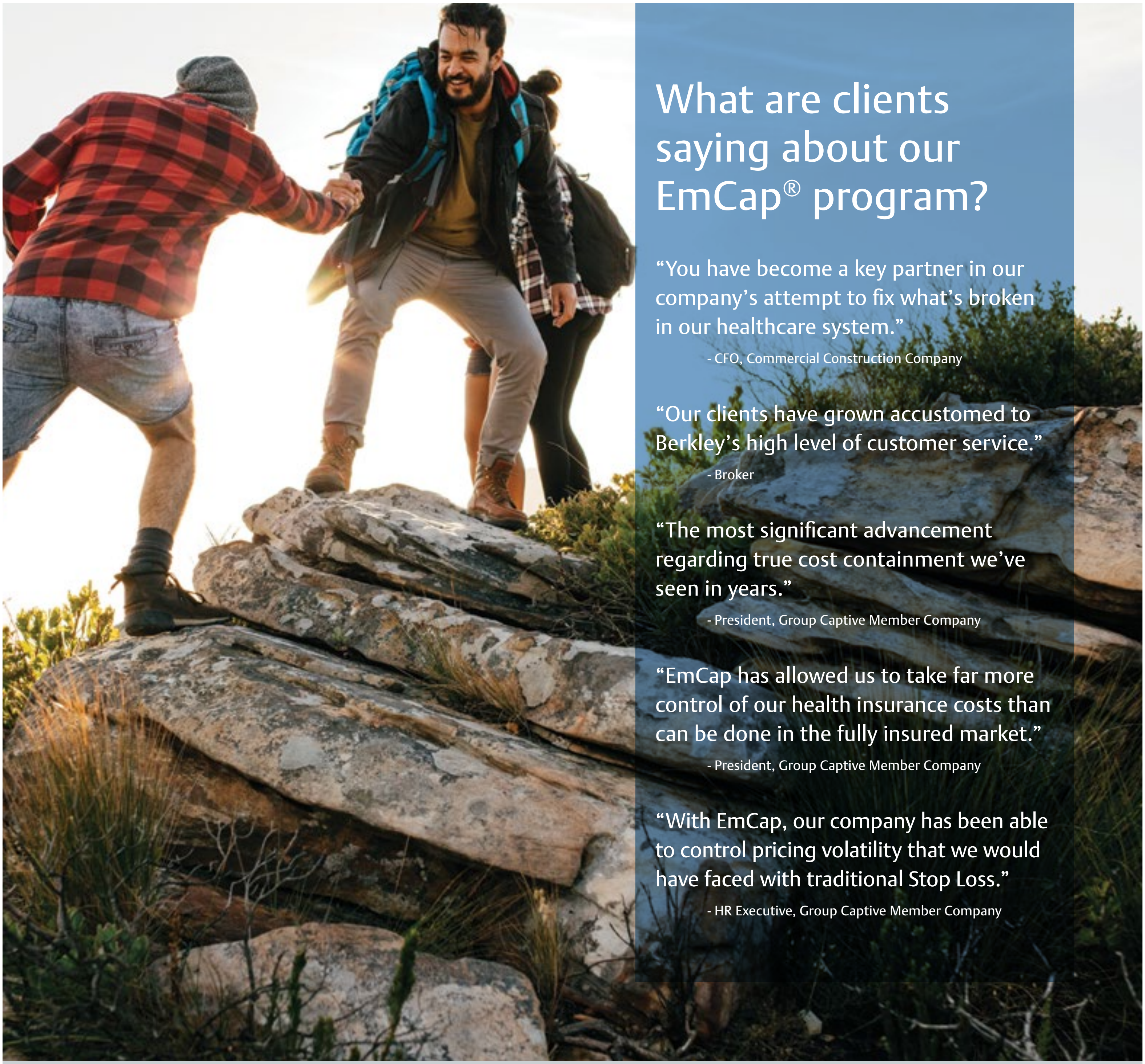
Now, as business has been turned upside down for many companies, he suggests looking at the data more often.

“When things are rapidly changing with a client, looking at a certain metrics such as quarter to quarter changes might make more sense. For example, with workers compensation we are looking at a couple of things. Did the client experience a significant drop in payroll due to closed or limited operations? That’s going to affect their losses, so there could be a lot of initial information for us to analyze and then make adjustments to our original estimates.”

For Belokas about GPW and Associates, they approached the problem this way, “Because the full extent of the impact of the pandemic is not yet known, we performed a stress testing of the assumptions to estimate the impact under various alternative assumptions. For example, we were engaged to analyze a captive insurance program and the risk of reinsurer default resulting from pandemic losses. This engagement required us to review Executive Orders mandating business closures throughout the U.S. and to analyze the business interruption impact of those Executive Orders on insured businesses.”

“I think almost every benchmark that actuaries use is going to be impacted by COVID this year,” said Walling. “It doesn’t matter if it’s long-haul trucking frequencies or workers’ comp loss development patterns, every industry has these weirds drops and surges. Take auto dealers for example, nobody sold any cars during the second quarter but once things started opening up, auto sales surged in the third quarter. The entire auto industry has this weird data where no cars were being shipped, no cars were being bought, so for the transportation and dealer side of the auto industry, all of their revenue data and their payroll data is unusual. For trucking companies, if you were hauling for Amazon, your results look great in the second quarter, but if you were a car hauler you were laying off all your people.”

As Walling’s example shows, every industry was affected differently, and even within the same industry each company had a different experience. This makes it harder to aggregate any data that is coming in. Not being able to look back to the previous five or ten years is pushing captives and risk managers to look to innovation.



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"The pandemic may not affect the amount of available data, but it has driven innovative approaches to handling low-data situations," said Rhodes. "I think one of the 'benefits' of the pandemic would be that it is forcing risk managers and analysts to update approaches or methods that have proven to be outdated."

He continued, "I think some innovation is due to the fact that risk management departments are being forced to use more in-depth analytics. Instead of just doing what they've done in the past, focusing on just the risk part of their job, they are going to focus more on metrics, data, and analytics. In the past, we didn't see many smaller risk management departments employ analytics in a dedicated manner. The pandemic is forcing them to become more innovative in this aspect."

## WHAT THE FUTURE HOLDS

With the limited data available from the beginning of the pandemic, actuaries can now start to compile data for future events. According to Belokas,

"Analyzing the impact to clients that had pandemic coverage during March and April 2020 provided us an opportunity to observe the impact and will help in analyzing the exposure to future pandemics. However, we must be careful to recognize that future illnesses and the reactions from businesses and governmental authorities are unlikely to be exactly like COVID-19. Any estimate of future losses needs to recognize this uncertainty."


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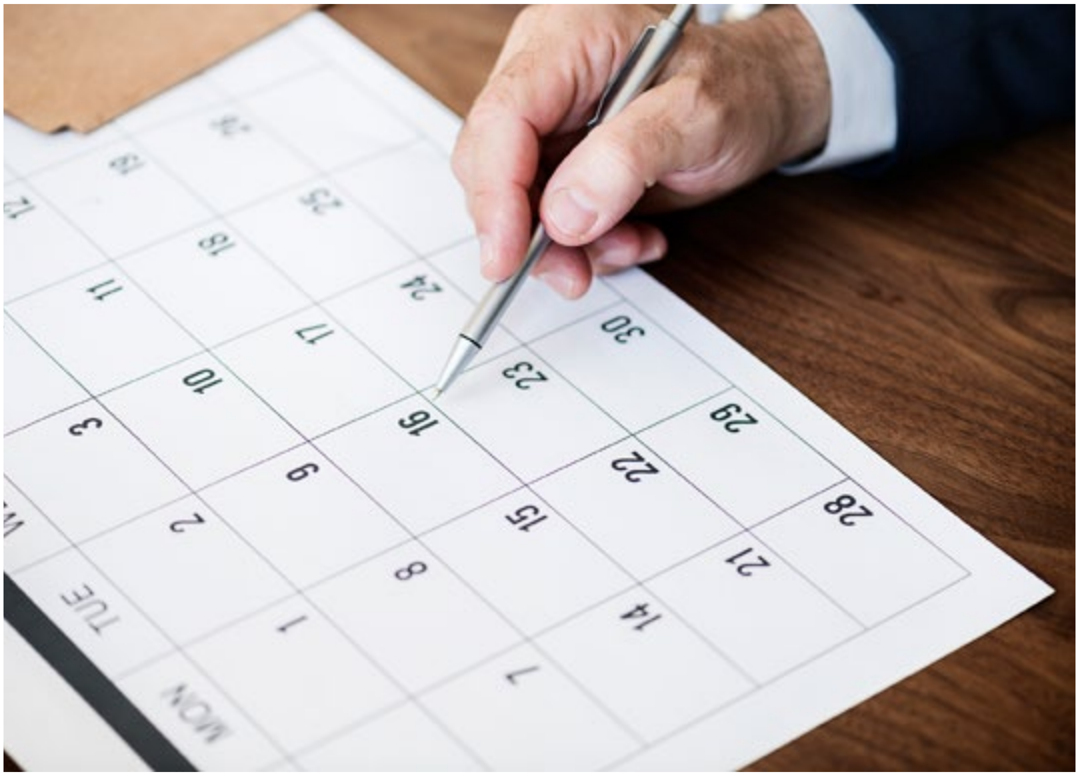

Captives flourish when there is uncertainty in the insurance market and they will continue to grow as commercial carriers become more conservative in their policies.

"I expect commercial insurance carriers will continue to narrow language to specifically exclude pandemic-related losses," said Belokas. "Captives have a proven history of protecting businesses from losses not well handled in the commercial insurance marketplace. Pandemic-related losses clearly fit this category and I anticipate most or all captives will write (or continue to renew) coverage for pandemic-related losses at the next renewal."

A more immediate concern for actuaries is that pricing policies and renewals are going to be difficult over the next two years.

According to Rhodes, "A lot of companies out there have year-end policies–January to December–so the upcoming year-end renewals will likely be difficult on the insured side. We are going to have some clients that look very different from the beginning of the year and some clients that will look virtually the same. For clients whose operations have been impacted, it will be challenging to price for next year."

Walling has a similar view, "I think we're going to see a lot of conservative estimates at year-end because the last thing anyone wants to do is take an overly optimistic view. We simply don't know if or when there will be a vaccine for COVID-19. We don't know if there is going to be another bubble over the holidays. We keep seeing these regional outbreaks. We honestly don't know how close we are to the end of this."

2021 will continue to see unusual data sets and depending on how COVID-19 continues to spread, businesses will likely see more unusual behavior in the marketplace. Rhodes said, "All of the data from 2020 and 2021 is going to be unusual. It could be longer than 18 months from now before the data gets sorted. It really depends on how quickly companies, and the economy, can get back to business as usual."

He added that many of his clients are hopeful. "What we're hearing from clients who had a slow-down—whether they had to furlough employees or had reduced sales—they do think things are going to pick up."

Still, with no end in sight for the pandemic, actuaries will continue to look to new ways to do their work. As Walling said, "For an actuary, a moving target is the hardest one to hit, so actuaries rely the idea that the way the next year is going to play out can be predicted on the last five or the last ten. There is nothing in the last ten that would have predicted this." ■

Karrie Hyatt is a freelance writer who has been involved in the captive industry for more than ten years. More information about her work can be found at: www.karriehyatt.com.