REPUTATIONAL RISK EMERGES FROM PANDEMIC WITH RENEWED FOCUS

Written By Karrie Hyatt

Reputational risk, considered an emerging risk over the last decade, has suddenly entered the spotlight as one of the most important risks a company can manage. While there are box-standard insurance products for this risk, the fluid nature of reputational risk makes insuring it through a captive a much better prospect.

In January 2020, well before the COVID-19 pandemic wreaked havoc on the world's economy, the RepTrak 2020 Global Trends study found that 70 percent of risk managers believed that managing reputation for their company was more important than it had ever been before.

WHY REPUTATIONAL RISK?

Reputation is one of several intangible assets that have become as important as, and in some cases more important than, what are traditionally considered assets, such as cash and property. Other intangible assets that are also becoming increasingly important relate to cyber risk and business interruption risk, and all three can occur from similar events.

To define it, reputational risk is when a company's established character or good standing is threatened by the actions of the company, through the actions of an employee or employees, or through a connection with a third party. Or, as Jerry D. Messick, CEO of Elevate Risk Solutions, puts it, "An event that causes a decrease or reduction in a company's value based on public perception."

As use of the internet has grown, particularly social media, companies insuring their reputation has increased substantially. When news breaks, whether substantiated or not, and its dissemination is amplified, a company's reputation can be undone in a few days. Reputations that took years, or even decades, to build can be demolished by an ill-timed Tweet and takes far longer to make a recovery.-

In April, the Howden Group released a report, titled "Insuring the Invisible," that expressed how a company's intangible assets have become so important. "In recent years, as economic value has shifted from tangible to intangible assets. The proliferation of data, technology, and automation has revolutionized the way people live, interact, work, and travel. It has also transformed the composition of companies' assets: today, most corporations value IP, brand and reputation ahead of property, plants and equipment. Even organizations that manufacture physical goods now typically offer complementary data and advisory services."

According to Messick, "I think the 'always on, 24-hour-a-day' nature of (social) media is impacting recognition. When a company's sales can be impacted so dramatically by negative comments on social media, they must focus on mitigation and have a way to fund those efforts."

As reputation becomes more vulnerable, customers and clients are increasingly ready to call to account companies when expectations are not being met. Risk managers have to be constantly on top of potential threats, and many reputational risk plans have a component that monitors media and other potential issues.

For executives and boards, managing reputational risk is about using data and intelligence to identify threats and to protect loss. Well-developed risk plans now include reputational risk insurance coverage.

For many types of risks, claims can take months or years to realize. When a reputational risk event occurs, companies will feel the financial effects immediately—through bringing on a crisis management team, including public relations professionals, to handle the fallout and through the loss of sales, partners, or investors.

The pandemic demonstrated to many businesses just how important a company's reputation is. "With COVID much has been learned," said Michael A. Corbett, senior vice president with Pinnacle Financial Partners. "Protecting the reputation of a firm includes getting the message out to customers via broad based communications including media (both free and paid), internal communications, networking, operations, industry partnerships and, of course, social media."

For Messick, "I believe the pandemic helped focus the need to have plans in place to address a 'public perception' event, especially in the healthcare industry. Hopefully, if we learned anything from the pandemic, we learned that having a plan in place is vitally important because we simply don't know what's going to happen at any given time."

INSURING REPUTATION

Reputational risk can be hard to define as it has many components that come into play. Every type of business and each individual company will have different factors that expose them to reputational risk. Yet, it can be quantified which is why it can be insured. Insurance policies for reputation usually covers short-term profit loss and addresses costs for crisis management and reputation mitigation. Policies can also cover sales forecasts providing companies assurance that their business plans see less interruption.

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Before reputational risk emerged as a singular risk, a form of it could be found in defamation policies, then as part of cyber-related coverage and product recall coverage. During the last few years, reputational risk insurance policies have come out as a stand-alone policy.

Many traditional insurance companies offer reputational risk products, but off the shelf policies can't attend to the nuances of each company leaving gaps in coverage. According to Messick, "The traditional market addresses a broad array of risk and typically doesn't provide focused strategies within the coverage form. As an example, in the event of an alleged physical abuse situation, does the coverage form provide for immediate attorney and public relations expense when the police and press show up at the front door?"

Quick response and flexibility are necessary to mitigate any long-lasting effects of an event threatening a company's reputation. While an event that triggers a reputational risk policy is going to be rare, it is for that reason that putting this risk into a captive is the best option. Low frequency, high payout risks are what captives can excel at.

"Companies are as different as snowflakes," said Corbett. "Off the shelf coverages by traditional carriers may not be tailored enough to suit the needs of every client. Captives provide the flexibility to tailor policies and how claims are paid that fit a particular company."

Corbett continued, "Captives have covered reputational risk in the past; however, given the effects of COVID (i.e. a crisis), previous policies proved deficient in providing protection. It is perhaps best illustrated by counting the number of companies that were able to file claims for business interruption. Industry has indicated that it could be done on one hand! This is a problem in need of a solution, hence captives offer a solid solution."

Jerry Messick offered a real-life example of how reputational risk can be successfully insured through a captive, "We had a case in a long-term care facility captive where the police and press did show up. The [facility's] policy in the captive allowed them to immediately respond with an attorney that drove there within one hour. In addition, they engaged the public relations expert that was on retainer by the captive to respond to exactly this type of event."

As a method for dealing with a crisis, reputational risk insurance is irreplaceable. As many companies found out during the pandemic, insuring crisis, especially through a captive, can be an effective way to stay in business. Corbett said, "With COVID, companies have learned some very valuable lessons: Be prepared before a crisis arrives; decisions during a crisis risks damage to a reputation and shareholder value; responses need to be quick and decisive; it is possible to emerge from a crisis stronger; and the major lesson… when you think the crisis is over, it probably is not!"

As more and more companies are facing critical risk to their reputation, and therefore livelihood, insuring that risk is imperative. With the flexibility of insuring risk through a captive, companies will be able to bridge coverage gaps to keep business running smoothly, even when crisis strikes. ■

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.