

The Cyber Captive Option



Cyber attacks are a real threat, and captives may offer the best protection.

Captives are emerging as a viable option for cyber coverage when the commercial marketplace lacks affordable options.

By Alex Wright

Cyber risk has become the top priority for many companies following the recent spate of high profile data breaches and hacking attacks that hit the headlines, including Target, JP Morgan and AT&T, to name but a few.

However, they have often struggled to find the right coverage in the commercial insurance market at an affordable price.

As a result, some companies are turning to the captive market, with a recent Aon study revealing that 7 percent of captive owners surveyed have indicated an interest in underwriting cyber risk through a captive.

Given the nature of cyber risk, a captive program can often be an

attractive solution, allowing the owner to diversify its risk portfolio, build up its reserves and cover risks such as future lost revenue or first-party loss of inventory that are not always readily available in the traditional market.

It can also cover highly correlated risks including cyber and reputation that aren't always included together in the commercial market.

Having a captive also allows the owner to assume a high deductible and/or higher coverage limit and to fund it through the captive in order to gain access to reinsurance markets offering cyber coverage.

Furthermore, it can allow companies to better track data and have greater control of claims, as well as provide access to various tax

and financial statement benefits.

The main captive domicile to benefit from this influx of new business has been the State of Vermont, which currently has 17 licensed captives that write cyber risk as a stand-alone policy, not to mention those that have an endorsement built into their general liability programs.

"Company executives and risk managers recognize the threat of a cyber attack and that it could have a significant impact on their organization," said Sandy Bigglestone, director of captive insurance at the State of Vermont.

"The risk managers of our captive owners understand and can measure their risk better than anyone, therefore considering a captive to address the problem of cyber risk is only a natural reaction to this phenomenon."

CYBER RISK — THE NEXT STEP FOR CAPTIVE OWNERS

Bigglestone said that writing cyber risk into their program was often the logical next step for many captive owners.

She said that the main advantage Vermont has for prospective and existing captive owners is a strong and well-resourced infrastructure, as well as, crucially, laws that allow for cyber coverage to be written into captives.

"Cyber coverage is another vital element of risk financing and control that a captive owner and their manager needs to explore and, if they decide to, then implement," she said.

"Here in Vermont, we have a host of highly skilled professionals who focus on managing, consulting and advocating for captive insurance companies, including attorneys, auditors, accountants, actuaries and consultants.

"They also have at their disposal a huge network of resources to assist captive owners with every type of solution, including cyber coverage."

Dan Towle, director of financial services for Vermont, said he has seen the benefit of this move toward



"Company executives and risk managers recognize the threat of a cyber attack and that it could have a significant impact on their organization."

— **Sandy Bigglestone**, director of captive insurance, State of Vermont

captives for cyber coverage. The problem is the traditional insurance market has failed to keep pace with the needs of the industry.

He said that because of the limited capacity available and existing exclusions on cyber coverage, captives are often a better solution for companies looking to insure their specific risks.

"I believe that the growth potential of cyber coverage being written into captives is tremendous," he said.

"Above all, they can fill many of the needs for cyber coverage that are not readily available in the commercial marketplace."

A CAPTIVE RISK MANAGER'S PERSPECTIVE

Gary Langsdale, risk manager at Pennsylvania State University, which owns a captive domiciled in Vermont that writes cyber coverage, said that as a higher education institute, it was often difficult to find the right policy in the commercial marketplace because of the risks associated with cyber, making a captive a more viable option.

He said that having a captive for this purpose gave the university the flexibility to self-fund its own program using a two-tiered deductible — the first for the academic units that don't follow good practice and the second for those that suffer a breach regardless.

"Over the years, it has become increasingly difficult for us to find a home for cyber insurance, largely because as a university we have a very open IT infrastructure as often we need to share information with publications and other external

collaborators," he said.

"That has meant that in the past commercial insurers have held that as a black mark against us, but having our own program has allowed us to get information about those breaches more readily and be more in control of our own risks."

VERMONT — THE DOMICILE OF CHOICE

Jason Flaxbeard, executive managing director at Beecher Carlson, which manages 24 captives in Vermont, said that the state's key selling point is its ability to be on the cutting edge of technology, as well as taking a risk-based approach to new coverages like cyber.

As a result, he said, Vermont has been proactive in opening its doors to new business and has already started to reap the rewards.

"I'm a big fan of proper and appropriate regulation and in having someone who will take your call and help you to work out a solution to your problem; in that regard, Vermont has always provided that service to a very high level," he said.

SUMMARY

- **Affordable cyber coverage** is hard to place in the commercial market.
- **Captives allow companies** the ability to diversify cyber risk portfolios and build up reserves.
- **Vermont offers** the experience and infrastructure other domiciles may lack.

"It's a mature domicile, and there are enough people there who understand the captive insurance industry and the risks associated, and above all they understand who their clients are."

Jim Swanke, director of risk consulting at Willis Towers Watson, said that Vermont's ability to provide "out of the box" innovative solutions made it an obvious choice for companies looking to write cyber in their captive programs.

"They got into the captive business in 1981 and they have really got the whole captive management process down to a science in terms of the regulatory environment and the solutions they can provide," he said.

Eric Detlefs, CEO of Cassatt, an insurance product and service provider, said that with more than 1,000 licensed captives on its books,

Vermont was the "gold standard" for captive insurance regulation.

"Vermont is an excellent place to base efforts to provide protection against rapidly developing exposures such as cyber risk," he said.

"As cyber and privacy breach risk continues to emerge as a widespread global threat, I think that the attractiveness of forming a captive for this purpose will become an increasingly popular option."

THE FUTURE OF CAPTIVES FOR CYBER INSURANCE

Julie Boucher, Marsh Captive Solutions Practice leader, Americas, said that the use of captives for cyber coverage would only continue to grow in the future.

"The growth potential is huge because every day I see the ongoing conversations between captive managers, regulators and service

providers, and the complexity of analytics around the use of cyber in captives continuing to evolve," she said.

"For the moment, it remains to be seen how many captive owners will actually pull the trigger, but the interest is certainly there."

Bigglestone believes that as companies continue to develop strategies to deal with cyber risk, the uptake of captives for that purpose will only increase going forward.

"I expect that Vermont's role will be significant in that space, as we become more experienced with cyber risk, and well-positioned to accommodate new captives seeking to write cyber coverage, and existing captives expanding their businesses," she said. **&**

ALEX WRIGHT is a U.K.-based journalist, formerly based in Bermuda. He can be reached at riskletters@lrp.com.