REPUTATIONAL RISK – WHAT ABOUT THE LITTLE GUYS?

Joe Ziolkowski, of Hamilton Captive Management, reflects on the development of reputational risk programmes in the marketplace, and the move towards offering solutions for small- and medium-sized entities

Captives, even more so than the London market, are the laboratories of the general insurance marketplace, where innovation and product development are almost requisite byproducts. It is within captives that emerging risks can find capacity and underwriting models can be developed and refined. In this sense, the concept of insuring a company's reputation – a risk that only seven years ago was largely deemed to be uninsurable – is right at home, especially when it comes to the underserved small to middle market. However, before we discuss the means by which captives provide such a solution, it's worth taking a moment to compare the current state of reputational awareness relative to the traditional risk transfer solutions available in the marketplace. Of course, within the context of "the little guys" we'll focus particularly on the breadth of solutions available to the private business owner.

With the public's seemingly insatiable appetite for headlines, coupled with the omnipresence of social media and the 24-hour news cycle, the threat of damage to a company's most prized intangible asset – its reputation – has never been more tangible. No longer is the sensitivity to a company's reputation relegated to only those individuals occupying the boardroom; these concerns are shared by nearly every stakeholder of the company, including employees, investors, creditors, competitors, vendors, consumers and regulators. As part of Aon's *Global Risk Management Survey – 2017*, compiled from the responses of more than 2,000 public and private firms worldwide, damage to a company's

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reputation and brand was ranked the number one risk for the second consecutive survey – outpacing even the threat of an economic slowdown, regulatory change, and cyber crime. In other words, the widespread awareness of the value that can be generated or lost based on the public's perception of a company is well documented.

In light of the above, someone not immediately involved in the insurance and risk management industry might assume that there exists a supply of insurance products that corresponds with demand. Especially in light of the *2015 Insurance Department Resources Report*, which detailed the 2,535 domestic property and casualty insurance companies and thousands more non-domestic regulated insurance companies that are licensed to transact business in the United States. Yet today, by all accounts, there are only five markets that offer a standalone reputation insurance product, each with its own unique scope of coverage and triggering events (*see table below*).

A full-scale coverage analysis of the products listed below is beyond the scope of this article; however, it's also important to understand the narrow market of prospective policyholders being targeted by these providers. Generally, with the exception of ReputationGuard, the insurers are targeting publicly traded companies with annual turnover in excess of $500m and typically include $1m self-insured retentions. This begs the question: where do the rest of the business owners, comprising 99.7% of all businesses, turn for a reputational risk transfer solution? Crickets...

The reality is that if you are a business owner seeking a comprehensive reputational risk policy that will protect your balance sheet, provide you the liquidity needed to fund the crisis management effort, and indemnify your business for lost

			Scope of coverage		
Insurer/market	Product name	Product launch	Pre-event mitigation	Crisis communication	Lost profits
AIG	ReputationGuard	Oct 2011	No	Yes	No
Allianz	Reputation Protect	Oct 2012	Yes	Yes	No
Munich Re	Reputational Risk	Apr 2012	No	No	Yes
Kiln	Reputational Harm	May 2012	No	Yes	Yes
Steel City Re/ Tokio Marine Kiln	Reputation Assurance	Nov 2012	Yes	Yes	Yes
Zurich	Brand Assurance	Oct 2011	No longer marketed		

income in the wake of a reputation-damaging event, the products available to you within both the traditional and E&S markets are virtually non-existent. Enter the captive solution.

As a manager of captive facilities primarily insuring the small- to middle-market (businesses with 20–500 employees; annual turnover from $5m-$500m+), I have seen the underwriting approach, pricing support, and insurance contracts for reputational risk improve significantly over the last six years. However, what has remained constant is the overarching objective to deliver an enhanced solution, both for the insured and the insurer. Solution delivery for the insured is geared to achieve three primary objectives: 1) raise awareness at the operating level regarding proactive measures to minimise the frequency and severity of a reputation damaging event; 2) transfer the economic risk of loss arising from such an event in a manner that preserves cashflow stability and protects the business' assets; and 3) provide ready access to reputation management and communications expertise to ensure a swift response as soon as an insured has the inclination an event may be likely.

However, in a classic chicken/egg scenario; it's challenging to deliver on the above objectives without refining the rate development and underwriting on which to build a growing reputation insurance programme, especially one that's tailored to the needs of businesses of different shapes and sizes, all the while maintaining adequate and transparent pricing support. It has been a pursuit of loss costs based more on quantitative, objective data and less so on judgment rating; policy forms clearly communicating the scope of coverage with defined triggers instead of ambiguous verbiage; and defined underwriting classifications to properly evaluate each new account. Fortunately or unfortunately, another variable that influences the urgency behind this process is the over-reaching regulatory scrutiny that is continually challenging substance over form with respect to small captive arrangements. For our firm, it has been a constantly evolving process that has involved several independent actuarial firms, each of whom was an improvement on the predecessor. However, we hit a major break in this process early in 2016 as I was searching for a more robust reputation insurance solution for a celebrity client of ours that needed more capacity than his captive or our programme could provide.

After some research, I reached out to Steel City Re, the recognised leader in reputation value metrics. Before I picked up the phone, I was encouraged for a number of reasons, the most important of which was a surfeit of analytics across 19 different industry sectors based on nearly a decade of data extracted on a weekly basis for 7,500 public companies – the foundation of the company's proprietary reputational value metrics. Of equal significance was their on-the-record acknowledgment of the importance of providing pure risk transfer solutions and alternative risk transfer solutions involving captives. The $100m of capacity behind their underwriting model led by Tokio Marine Kiln was an additional feather in their cap. Less encouraging was the apparent focus on publicly traded companies and the documented reference of targeting companies with at least $1bn in annual turnover, i.e. not our clients. While the beginning of the first conversation focused on our celebrity client, there was an almost immediate understanding of the greater opportunity: develop a more robust reputational risk programme specifically applicable to our privately held client base.

Long story short, between May and October 2016, we worked with Steel City Re as they massaged their standard operating procedures to accommodate the nuances of a privately held business. From risk profile modelling, quantitative analysis and projections, coverage triggers, and underwriting procedures, the end result simply was a better mousetrap for our clients in their capacity as both the insured and the insurer. This new programme provides them with a wealth of guidance on proactive measures to minimise the likelihood and impact of a reputation-damaging event; the ability to quantify the amount of risk that's being transferred away from the business while increasing the scope of coverage to include indemnification for lost profits; and provide efficient access to targeted expertise in reputation management and crisis communications. Additionally, those clients in need of capacity above and beyond that available within our programme can now directly access reinsurance capacity through Tokio Marine Kiln. Needless to say, we are still in the early stages of phase 1 of this laboratory experiment, and not yet in a position to form conclusions; however, we are optimistic as we prepare for the next phase.

While this article is certainly not intended to be a puff piece for Steel City Re, or Hamilton for that matter, it is intended to bring awareness to two important points. First, while the general insurance marketplace cannot yet accommodate the reputation-based needs of the small to middle market, business owners can confidently turn to a captive solution to begin building a reputational war chest of risk capital and governance best practices. Secondly, while small captives have come under an unjustifiable amount of regulatory scrutiny of late, a properly structured captive insurance company is a holistic solution that has the potential to create long lasting value for the affiliated business – value that reaches far beyond a reputational risk insurance programme, and certainly beyond the opportunity for tax efficiencies along the way.