MARSH

INSIGHTS | APRIL 2020

Improving Liquidity During and After the Pandemic

Beyond its effect on people, the continuing COVID-19 pandemic has had severe effects on the US and global economies. Maintaining liquidity can act as a bridge until economic activity improves, and a number of insurance and risk management strategies can enable that process.

Cash Flow Challenges

Since the pandemic began, businesses have had to contend with volatile financial markets and uncertainty about their current and future revenues and cash flow. With worries about a potential recession growing, many businesses have taken steps to preserve cash — including laying off or furloughing employees and shutting down production — while exploring potential lines of credit and other ways to maintain liquidity. The White House, Congress, and the Federal Reserve have also introduced a major stimulus package, lowered interest rates, and taken other measures to ease companies' pain and ensure capital is readily available.

But adverse effects and uncertainty for businesses will likely persist for some time — with the worst possibly still to come — which underscores how important it is for businesses to preserve cash. In addition to any actions they may have taken so far, businesses will likely need to explore other solutions, such as claims and collateral cost reduction strategies, credit insurance products, premium financing, and the use of captive insurers — all of which can help them stay liquid.

Reducing Claims and Collateral Costs

Although many employers' workers' compensation losses will fall in the short-term — as fewer people are working and social distancing measures remain in place — injury rates may increase for some. And employers of all types may experience delays in key processes and the resolution of existing claims, during which time injured employees will continue to collect benefits.

Outstanding liabilities associated with aging inventories of open workers' compensation claims can significantly reduce the amount of working capital — both short- and long-term — that is available to companies. Settling these claims proactively, however, can help employers improve their balance sheets given uncertainty about the post-COVID-19 economic environment.

A strategic approach to closing legacy claims can enable employers to better manage their cash flow. Working with insurance and claim advisors, employers can use analytics and claims inventory management tools to aggressively reduce their liabilities and reserves; for Marsh clients, the current average paid for legacy claims closure initiatives on each $1 of reserves is $0.72. Lower claim volumes and associated outstanding liabilities can also help reduce collateral and overall loss costs.

Employers should pay particular attention to the adverse development of new and existing claims. Though resources may be limited, employers can use analytics and other claims monitoring tools to identify potentially difficult or complex claims and prioritize resources on them. They should also proactively reach out to injured workers and help them navigate the current environment, which may prevent costly litigation in some cases and can contribute to better claim outcomes and lower costs.

Replacing Letters of Credit With Surety Bonds

As businesses face higher financing costs, limited access to credit facilities, and falling counterparty value, surety bonds represent a viable means for posting collateral, and an attractive alternative to bank letters of credit (LOCs).

Unlike an LOC, a surety bond does not count against a company's overall borrowing capacity, nor is its pricing tied to interest rate fluctuations. This means that surety bonds can be more cost-effective than LOCs and can enable principals to free up capital and credit for other, more productive uses. They can also allow principals to avoid being overly reliant on the relatively small group of banks that constitute much of the market for LOCs.

Businesses are increasingly using surety bonds to meet a range of collateral commitments. These include posting security for large leases, meeting court demands while appealing adverse rulings, and satisfying requirements for self-insured workers' compensation programs and other forms of insurance coverage.

Financing Premium Payments

Preserving and strategically deploying capital is vital to a business's success at any time, regardless of market conditions, but it is critically important now. Premium financing can help businesses to preserve working capital that would otherwise be used to pay commercial insurance premiums.

In most insurance transactions, a buyer makes a single upfront premium payment — or pays a majority of the premium upfront — in return for coverage over the next year. A large upfront payment can prevent a business from meeting other critical and cash-intensive obligations, including payroll and supply chain expenditures, at the time a policy incepts or in the future.

Premium finance allows insurance buyers to use third-party capital to fund their premium payments. Subject to the premium finance transaction, a premium finance company pays insurance premium on behalf of the policyholder, with the underlying policy serving as collateral for the loan. This allows the insurer to collect premium upfront and extend coverage to the policyholder without the need to tie up valuable assets or encumber any credit facilities. For insurance buyers of virtually any line of coverage, premium finance can serve as an effective cash management tool whereby the policyholder can both secure necessary coverage and preserve capital that can be used to meet immediate or long-term needs.

Using Trade Credit Insurance to Protect Accounts Receivable

Typically, accounts receivable represents approximately 35% to 40% of a company's assets. Trade credit insurance can help a company protect these assets from losses caused by insolvency and default, among other potential risks, and help them improve their liquidity.

A trade credit insurance policy, meanwhile, can be used as security for additional liquidity. Assigning a policy to a bank or financial institution enables receivables to be used as a secured asset against which a bank can offer funds.

Funding can also be provided through a factoring agreement supported by trade credit insurance; a bank would have its own trade credit policy, purchasing invoices from its customer with support from insurers on exposures. In the event of a claim, trade credit insurance can indemnify a policyholder for up to 90% of the loss.

Lending and Returning Profits to Captive Parents

Among other benefits, captives can extend loans to parent organizations or invest in other parent company assets, including real estate and trade receivables. A captive can also return profits to a parent via dividends and fund a parent's risk management expenses, including large risk consulting projects.

Whether a parent organization can pursue these strategies, however, depends on the financial health of a captive — namely, whether it can generate surplus and/or reduce the amount of surplus required by its regulator. Captive owners may be able to achieve this via:

- **Reserve reviews.** A systematic process, such as a claim inventory workout, can lower a captive's loss reserves and generate more surplus.
- **Purchasing reinsurance.** This can lower overall surplus requirements, since a captive would retain less exposure.
- **Discounting loss reserves.** This would result in a lower book value and corresponding increase in surplus.
- **Adjusting premium-to-surplus ratios.** Increasing this ratio can result in both a lower surplus requirement and enable captives to increase loans and issue dividends.

Pursuing these strategies can help parent organizations generate liquidity immediately and in the long run; since the pandemic began, parent organizations of Marsh-managed captives have freed $2.6 billion from their captives to aid their cash flow. These strategies, however, may require regulatory approval, detailed financial calculations, and input from tax advisors and other professionals.

Staying Liquid

As the financial and economic effects of the pandemic continue to put a strain on businesses, financial and risk professionals should explore their options for addressing cash flow challenges. And they should work with their advisors to consider these and other insurance and risk management strategies that can help ensure their liquidity as the crisis continues.

For more information, visit our Pandemic Hub on marsh.com, contact your Marsh representative, or send an email to questions@marsh.com.