CAPTIVES PROVIDING STABILITY TO CANNABIS INDUSTRY

Written By Caroline McDonald

The growth of the cannabis industry and the reluctance of the federal government to legitimize the industry have created serious issues with insurance coverage of cannabis businesses. Premiums have remained high, and coverage can be patchy. This has made captive insurance an attractive option for the industry.

In its 2023 report by the Center for Insurance Policy and Research, the National Association of Insurance Commissioners states:

> Demand for cannabis is increasing dramatically. Thirty-eight states and the District of Columbia (D.C.) have legalized some form of medical marijuana. Recreational marijuana is legal in 19 states and D.C. The division between state and federal status makes it difficult for businesses to receive inclusive, affordable coverage and often leaves policyholders with restrictive plans.

The report continues that because of restrictions on banking, cannabis-related businesses can be forced to operate on a cash-only basis, increasing the possibility of theft and liabilities.

The Secure and Fair Enforcement (SAFE) Banking Act, which would allow CRBs access to financial institutions› products and services, was passed by the House of Representatives in 2021 but currently awaits action in the Senate.

The proposed Clarifying Law Around Insurance of Marijuana (CLAIM) Act would expand insurance coverage options for businesses and remove federal barriers for insurers to conduct business with cannabis-related companies that are legal in their respective states. The CLAIM Act also awaits further action.

To ease restrictions on cannabis, the Biden administration has announced that the U.S. Drug Enforcement Administration will move to recognize the medical uses of cannabis and reclassify the drug from a Schedule I to a Schedule III but will not legalize cannabis for recreational use.

THE ROLE OF CAPTIVES

There is an increasing need for captives, said TJ Frost, president of Symphony Grow, the Specialty Business of Symphony Risk Solutions. "With the cannabis industry being where it is today – a multi-billion-dollar industry and a lot of multi-state operators and publicly traded companies – millions are being spent on insurance premiums," he said. "But they don't have the traditional benefits other businesses have." Captives, he said, are a way for these organizations to control their fate when it comes to their risk portfolio.

That lack of clarity led Frost to begin working with surplus lines markets, with a focus on finding the right insurance partners for cannabis companies.

"I was one of the first to get into the cannabis insurance market in 2013," he said. "I've wanted to launch a cannabis captive for ten years but finally had success in doing so. We built an exceptional team with the right knowledge and expertise to get this over the finish line," Frost said. "We looked at all the necessary options before approaching reinsurance and captive management, and it finally worked out."

Their captive program, Symphony Grow, was officially announced in early March 2024.

Symphony Grow, he said, gives companies several options to choose from. "We can do single-parent captives. If the client wants to own their own company captive, we have the ability to do that. We can also do group captives and segregated cell captives, in addition to placing traditional property & casualty insurance coverages."

Frost said, "We currently have multi-state operators and publicly traded companies. They have been interested in looking at the captive and the cost analysis of a captive." These are companies spending $1 million plus in insurance premiums. "They see the greater benefit of being in a captive or owning their own captive," he said.

The response from the industry, he added, has been favorable. At a recent international conference for the cannabis industry, in fact, "We held 37 meetings in two and a half days that were focused on the captive. So, the word is out, and it is extremely positive for us."

OTHER CAPTIVE OPTIONS

Smaller companies in the cannabis market also have options with captives. "Groups we are looking at are in a specific size range – 52 up to 1,000 lives, enrolled employees," said Dane Bernhardt, director of data and analytics at HUB International Insurance Services.

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Hub, he said, established an employee benefits group captive in 2019. "Our stop-loss partner in this is Berkeley. They have identified the risks for the cannabis industry to be better than the average pools," he noted. "And so, they are bullish about the risk and invested in this program."

Part of that, he said, stems from an analysis by Tillinghast, "which found that the actuary models determined that the demographics that workers in the cannabis industry tend towards the younger side."

He added that they found the level of large claims to be more manageable and that "the demographics joining this industry are more health conscious, and I believe that is the largest component."

The captives are open to any cannabis-touching group, "such as retail, point of sale, technology solutions, it's an open book," Bernhardt added, "We want to spread out the risk as much as we can and with as many participants as possible. So, we're not restrictive as to who in the cannabis industry can join, and we find that this helps balance out the risk."

One of the biggest challenges, he said, is the rate of consolidations in the cannabis industry that continue to occur. "We're seeing a lot of growth in the industry, and we're starting to see more need for stability emerge. Previously, it's been more of a short-term game in terms of consolidating."

Captives are good for both the short and long term, Bernhardt said. While most people don't see them for the short term, "We work with a real estate firm that leases growing facilities to cannabis companies, and we've seen a lot of savings from some of the cost containment tools we're able to put in place in the captive programs."

With these, small groups "can behave like much larger organizations and go into a funding model that is essentially unbundled," he added. "They have control over their plan documents and their plan design, and they also have access to cost containment tools that they would not have access to in any other funding model. We've seen tremendous savings in the short term," Bernhardt said.

IMPACT OF FEDERAL MEASURES

Whether in the cannabis business or the insurance world, "A lot of people view federal legalization of cannabis as imminent, something that will happen soon," said Rich Golz, principal for Symphony Grow, who focuses on designing and implementing risk management and insurance programs. "By extension, that will be what gets the large traditional insurance markets into the space."

While some believe that because of this, there is no rush to form a captive, "I don't see it that way," he said. "We've been following legislation and progress at the federal level for the past five years, and movement has been extremely slow. There doesn't seem to be a large appetite for progress."

An indicator, Golz added, is the inability to pass SAFE banking measures, "which would essentially enshrine federal guidance and give banks and institutions, like insurance companies, the explicit okay to work with cannabis businesses."

Since even that has been difficult to get support for, "I think we are at least five years away from federal legalization in any form," he said.

Golz observed that the recent announcement of the DEA's move to reschedule cannabis from Schedule I to Schedule III does have some important impacts for operators and is a big step in the right direction. "That being said," he noted, "I would not expect an influx of new capacity or insurers. Most who aren't currently participating are avoiding cannabis because it is federally illegal, and this move doesn't change that."

Once legislation changes do come about, Golz believes there will be a delay before a number of insurers begin to accept cannabis submissions. "Many of them are not looking at the industry or building the data now; they are ignoring it until the federal status changes," he said. "So, there's still a huge runway where this insurance market is going to be underserved."

Even where coverage is more commercially available, he added, "There are reasons why most Fortune 500 companies use captives. At a certain size, it still makes sense to start building that asset instead of paying insurance every year. They can also get access to reinsurance."

His clients are also looking at the competitive advantages of a captive, "where they are better able to control costs and insulate themselves from market changes, and also to build an asset and control their destiny in terms of coverage, and to better protect the business," Golz said. ■

Caroline McDonald is an award-winning journalist who has reported on a wide variety of insurance topics. Her beat includes in-depth coverage of risk management and captives.