

PCS Information Bulletin #5: COVID-19 Review

Monday March 30, 2020

Due to continued client demand, PCS has decided to publish further bulletins regarding COVID-19. This report is **for information purposes only** and **does not** constitute the designation of a PCS event. We have decided to provide this report simply to help the market understand the COVID-19 situation and to provide access to some of the resources our team uses daily for intelligence on this event. The information below comes from public sources.

Business Interruption Developments

Business interruption has become the most pressing issue in the market, and it comes up in nearly every conversation we have. The efforts across the United States to seemingly bypass physical damage triggers in property policies is indeed disconcerting and would have implications at every link in the risk and capital supply chain. New cases and discussions regarding governmental and legal action regarding business interruption are scattered across the headlines of many industry news outlets such as the following, <https://www.carriermanagement.com/news/2020/03/27/204936.htm>. PCS continues to monitor this issue closely.

Of course, these issues bring back memories of Superstorm Sandy, when New Jersey decided that the event was not a hurricane. The impact on hurricane deductibles is not forgotten.

Rather than summarize, we just suggest that you read the news article below. It's thorough and conveys the issues well on its own. No need for our spin on it:

<https://www.law360.com/insurance/articles/1257211/coronavirus-business-loss-bills-face-constitutional-hurdles>

Now, let's move on to the thornier issue for business interruption. Particularly for larger programs, there's a wide belief in the market that at least some insureds will find ways to meet the physical damage threshold, ultimately causing business interruption to be included. Following the property losses at the likes of Merck and St Gobain in 2017, which were attributed by some to "silent cyber," the analogous scenario for COVID-19 is being called "silent pandemic." It fits. If policy language is ambiguous or silent on issues regarding infectious disease – or if the physical damage threshold can be met in ways that may not have been contemplated – then pandemic could effectively wind up being covered. Most of the folks we've spoken with believe that (as with NotPetya in 2017 for cyber) some programs will wind up affected, but it won't be a systemic issue.

According to the Association of British Insurers, most businesses haven't taken infectious disease extensions to cover business interruption, while others have extensions that only cover named lists, such as SARS and bird flu. I learned a couple decades ago in my past life that armies always prepare for the last war they fought, not the next war they'll have to. And we can see that here. There are all kinds of questions about proximity to outbreak, sublimits, and so forth. While these issues do require careful consideration, minute detail expressed by staccato questioning on specific policy provisions shouldn't then be extrapolated into universal conclusion. (If you had to struggle through the works of Immanuel Kant in college, you'll appreciate this.)

For now, the resilience of physical damage triggers, for larger programs especially, will have to be taken on a case-by-case basis. This means disciplined wordings review, understanding your portfolio, and identifying particularly problematic risks. Also, for larger property risk books where underlying data may not be available or could be open to interpretation, ILW hedging may make sense, particularly early in the COVID-19 process. As the pandemic progresses and the risk to large programs crystalizes, it's likely that risk-transfer pricing could reach prohibitive levels.

Runoff: Future Deal Pipeline Drivers

When most people think of runoff, they tend to think of a handful of long-tail lines of business: for example, UK motor, other motor markets with high loss ratios, workers compensation (and similar covers worldwide), medical professional liability, and general liability. If the COVID-19 pandemic has the 12-18-month duration that some have predicted, there's room for the industry to be represented more broadly. This could become particularly true if there are regulatory, judicial, or legislative measures that fundamentally change how insurance contracts are treated and how claims are paid (as terrifying as this prospect is).

Let's revisit the risk that – in any major jurisdiction – insurance contract language is overruled, and insurers are honored to pay business interruption costs even when there's no (required) physical damage. There could be litigation that draws out the claim lifecycle, after which one could expect a heavily contested process in which insurers seek to recapture some of their original rights in order to fulfill their ethical obligations to their shareholders. Best practices for addressing these claims would have to be developed on the fly, with plenty of early missteps leading to how claim handling strategies are refined. You can see how seemingly short-tail property claims could wind up fodder for the long-tail mindset of the global runoff market.

The elevated risk of D&O claims from securities class action lawsuits – a staple of recessions and other challenging economic conditions – would also result in long-tail claims that could wind up in the runoff market. The same could be true for workers compensation, particularly if the (largely believed but yet to be proved) notion that economic strain leads to increased workers compensation losses comes to pass.

Further, a period of economic malaise instigated by the COVID-19 pandemic could drive more runoff activity from lines of business more traditionally associated with that sector. Asset impairment and the risk of increased claim frequency and severity – that former from opportunism and the latter, perhaps, from a judicial and regulatory environment pressed to favor the claimant because of economic conditions – could cause otherwise stable books of business to become distressed, increasing what would be the expected pipeline of runoff business in more normal times.

So, what could the runoff market look like at later points in the COVID-19 lifecycle?

First, there are the portfolios and companies that were already distressed and would wind up in runoff anyway. The deal pipeline was already reasonably robust in the fourth quarter of 2019 and through the beginning of the first quarter of this year. These books will probably still find their way into the runoff market, although there is the risk that they will be scrutinized for price, given the possibility of broader capacity scarcity as a result of global economic conditions. Additionally, there could be an increase in

runoff business for reasons more directly related to COVID-19, which could exacerbate that scarcity of available capital.

Additional deal flow could come from insurers whose books would have been stable if not for asset impairment or other performance issues. In many ways, these could be better books than what has come into the runoff market in the past, because the claims aren't necessarily distressed – rather, the insurer is seeking to address a different form of strain. Interestingly, this portion of the pipeline could ultimately serve as a test case for the strategic runoff thinking we covered in our fourth information-only COVID-19 bulletin, as it would be higher quality and ultimately executed (at least in part) for the purposes of positioning the seller for post-pandemic recovery.

Portfolios with lines of business that are sensitive to recession and other strained economic conditions (such as workers compensation and D&O) could also come into the runoff market in greater than expected volume. And, I have a feeling that D&O risk could be greater if “silent pandemic” claims fail to materialize. We don't have much to go on here, and once again, we turn back to the silent cyber claims of 2017 from NotPetya. The only significant possible loss that has gotten the market's attention is FedEx/TNT, which followed an economic loss for the company of \$1 billion from NotPetya and neither cyber nor property recoveries. If this is a signal that failure to recover “silently” could result in the sorts of activity that trigger D&O claims, then there's a possibility of an increase in claims in this sector, with at least a chance that at least some books could be divested to runoff as a way to reposition the original re/insurer for new business post-pandemic.

The most problematic potential risk to the market – and thus future driver of runoff pipe – appears to be regulatory or legal developments that overturn insurance contract language to benefit original insureds. This is the scalable version of the silent pandemic problem, in which states, for example, require insurers to pay business interruption even without the necessary physical damage triggers being met. Property would normally be seen as short tail and thus probably not likely to wind up in the runoff market (at least not with any scale). However, the legal activity that would presumably follow such a measure by state governments could extend the claim lifecycle significantly and thus make property look long tail. That alone could be a reason for insurers to move the risk off their books and start clean.

Finally, there could be further deal flow from insurers who want to free up capital or other resources to clean up their books so they can take advantage of newer – and presumably better – opportunities post-pandemic (i.e., runoff as something other than the risk transfer of last resort), as well as from the general consolidation trends that result from periods of widespread uncertainty.

PCS will continue to monitor the market and provide updated thinking on runoff as appropriate. We'll likely look deeper into the items on the list above next week and in the weeks to follow. If you have any specific views or questions on this, please do feel free to contact us.

COVID-19 Confirmed Case Reporting Update

The number of confirmed cases reported in highly affected areas continues to rise, with the United States, Spain and Italy having far surpassed China's reasonably stable count of ~81,000. Although, of course, there are questions about the reliability of the reports coming from China. For now, PCS would contend that this is more an emotional threshold than anything else. There are too many uncertainties regarding data from China to determine that the rate of infection has truly stabilized. The political issues are too significant to be dismissed easily.

That said, taken outside the context of comparison to China, the spike in confirmed cases in the United States, Spain and Italy is noteworthy. Italy is likely to continue to struggle with backlogged cases for testing, unreported cases, and other issues that could continue to drive increases. For Spain the situation is likely similar, although backlogs due to the speed of reported case growth in the early days of the cycle could be part of the challenge here. In the United States, attention remains focused on New York, but adjacent states could see increases as well, a fact that has already garnered political attention. New Jersey, in particular, became the second state with confirmed cases to exceed 5,000, according to CDC reporting, and it looks as though several more states may follow soon.

France and Germany continue to show rapid growth in confirmed cases across all reporting channels and thus should be monitored carefully for the foreseeable future. *For more information on parametric trigger issues and basis risk considerations, please review our two earlier information-only bulletins on COVID-19.*

Update: The Contingency Market

We've seen an updated estimated insured value of US\$2 billion for the Olympics, per Willis Towers Watson (<https://www.willistowerswatson.com/en-GB/Insights/2020/03/the-insurance-implications-of-the-coronavirus-catastrophe>). PCS still believes, based on conversations with the market, that the entirety is not at risk for now, given that the Olympic Games have been postponed for a year rather than canceled completely. While postponement certainly does come with a financial impact to relevant stakeholders, it's likely far less than that of a complete cancellation.

Useful Links from COVID-19 Data Sources

- US Government Federal Guidance - <https://www.usa.gov/coronavirus>
- Government of Canada Federal Guidance - <https://www.canada.ca/en/public-health/services/diseases/coronavirus-disease-covid-19.html>
- UK Government Guidance- <https://www.gov.uk/government/topical-events/coronavirus-covid-19-uk-government-response>
- Government of Mexico Federal Guidance - <https://www.gob.mx/salud/documentos/nuevo-coronavirus-2019-ncov-comunicado-tecnico-diario>
- ESRI COVID-19 GIS hub: https://coronavirus-resources.esri.com/?adumkts=industry_solutions&aduse=local_state&aduc=email&adum=list&utm_source=email&aduca=mi_smart_communities&aduco=coronavirus_hub_resources&adut=950533&adupt=awareness&sf_id=7015x000000iQIAAA2&aducp=operational_second_body_text
- WHO COVID-19 situation reports: <https://www.who.int/emergencies/diseases/novel-coronavirus-2019/situation-reports>
- CDC Overview Page: <https://www.cdc.gov/coronavirus/2019-ncov/cases-updates/summary.html> (includes links to testing locations, nature of transmission, etc.)
- Insurance Information Institute Corona Virus Toolkit - https://www.iii.org/sites/default/files/docs/pdf/covid19_toolkit_03162020.pdf
- Pharmaceutical technology Coronavirus COVID-19 outbreak: Latest news, information and updates - <https://www.pharmaceutical-technology.com/knowledge-bank/coronavirus-faqs-covid-19-categories/>
- CNN Live Coronavirus pandemic updates: <https://edition.cnn.com/world/live-news/coronavirus-outbreak-03-17-20-intl-hnk/index.html>
- Worldometers.info - <https://www.worldometers.info/coronavirus/country/us/>
- Wikipedia US pandemic - https://en.wikipedia.org/wiki/2020_coronavirus_pandemic_in_the_United_States
- European CDC - <https://www.ecdc.europa.eu/en/publications-data/download-todays-data-geographic-distribution-covid-19-cases-worldwide>
- GOV.UK - <https://www.gov.uk/guidance/coronavirus-covid-19-information-for-the-public>
- Public Health England - <https://www.arcgis.com/apps/opsdashboard/index.html#/f94c3c90da5b4e9f9a0b19484dd4bb14>
- Sante Public FR - weekly update - <https://www.santepubliquefrance.fr/maladies-et-traumatismes/maladies-et-infections-respiratoires/infection-a-coronavirus/articles/infection-au-nouveau-coronavirus-sars-cov-2-covid-19-france-et-monde>
- GOV of Canada - https://www.canada.ca/en/public-health/services/diseases/2019-novel-coronavirus-infection.html?utm_campaign=not-applicable&utm_medium=vanity-url&utm_source=canada-ca_coronavirus#a1
- MorgenPost.DE - <https://interaktiv.morgenpost.de/corona-virus-karte-infektionen-deutschland-weltweit/>

- Robert Koch Institute -

https://www.rki.de/DE/Content/InfAZ/N/Neuartiges_Coronavirus/Fallzahlen.html

If you have information that could be useful to PCS or the industry and would like to share it with us, please contact Tom Johansmeyer (+1 441 799 0009 / tjohansmeyer@verisk.com), Ted Gregory +1 201 253-6866 / tgregory@verisk.com), or your regular PCS contact. We'd be happy to connect with you. All information supplied will be held in the strictest confidence and only be used to inform industry-wide analysis that is fully anonymized.