PCS Information Bulletin #4: COVID-19 Review

Friday, March 27, 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.

Intelligence from the Ground: U.S. and International Property Claims

The following states have issued some sort of order limiting business operations and/or citizens from congregating or leaving their homes for non-essentials. But most appear to exempt insurance from restrictions and consider it as an essential business:

Alaska, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Kansas (Johnson County), Louisiana, Maryland, Massachusetts, Michigan, New York, Ohio, Oregon, Pennsylvania (7 counties), and Washington. New Jersey mentions financial services but makes no specific mention of insurance as an essential business. Most states identify healthcare, grocery stores, pharmacies, utilities, first responders, military, shipping and financial services as among essential businesses.

In states where only essential businesses are allowed to keep operations going during the coronavirus epidemic, it appears insurance employees who are not working remotely can continue to work in offices. They must still practice social distancing, limit human contact and, where possible, switch to remote work.

PCS has been in contact with many insurers across the industry. Many have activated their emergency business continuity plans and the feedback we have received is that they are taking care of their customers without disruption to service.
While the COVID-19 situation **has not been designated a PCS catastrophe event,** our team remains in contact with insurers and other market sources regarding potential claims activity related to the situation.

Business Interruption Developments

Lawmakers in Ohio and Massachusetts have proposed bills that would retroactively expand business interruption insurance policies to cover companies' losses attributable to the outbreak of the novel coronavirus, following on the heels of New Jersey legislators' recent introduction of a similar proposal.

On Tuesday, Ohio state Reps. Jeffrey Crossman and John M. Rogers, both Democrats, introduced H.B. 589, while Massachusetts state Sen. James B. Eldridge, also a Democrat, introduced S.D. 2888. Generally speaking, both measures would effectively rewrite certain business interruption policies to include the coronavirus pandemic as a covered cause of loss.

Much of the two bills' language tracks closely with that included in a measure proposed earlier this month by a trio of New Jersey General Assembly members in response to the spread of COVID-19.

The National Association of Mutual Insurance Companies, NAMIC, in coordination with the other trades, has submitted a letter to the recently formed Joint Committee on Coronavirus Response, a 16-member panel of House and Senate members in Oregon. The interim legislative committee was established to identify ways the state can limit the spread of COVID-19 and assist businessowners, employees, families, and individuals who have been impacted by the illness. The committee has been directed to develop legislative proposals to be considered during a special legislative session likely to be called by Gov. Kate Brown in April.

The trades' letter expressed concerns about the conceptual proposal that the Legislature may interfere with longstanding insurance policy exclusions and existing policy language. In the letter, the trades stated opposition to retroactively changing terms of a policy and the stated coverage exclusions "because the insurer and the policyholder have agreed in a contract that viruses are not covered, that means no premium has been collected by the insurance company to pay those claims. The policy purchased by each policyholder is priced to cover what it covers, not what it excludes."

According to the Insurance Information Institute, just 34% of small businesses nationwide carry Business Interruption coverage. Business interruption policies were generally not designed or priced to provide coverage against communicable diseases, such as COVID-19 and therefore include exclusions for that risk. Insurance works well and remains affordable when a relatively small number of claims are spread across a broader group, and therefore it is not typically well suited for a global pandemic where virtually every policyholder suffers significant losses at the same time for an extended period. While the U.S. insurance sector remains strong, if insurance companies are required to cover such claims, such an action would create substantial solvency risks for insurers and significantly undermine the ability of insurers to pay other types of claims.

In the U.K., Sir Roger Gale recently expressed objections to insurers sticking to policy wording and not providing coverage for business interruption claims. He has vowed to raise the issue with Downing Street after he was inundated with constituents complaining of firms not considering their application for support from their insurance policy.

Insurer Statements on Claim Handling during COVID-19

PCS has conducted a preliminary review of insurers' publicly disclosed perspectives on claim handling in light of COVID-19. We saw many statements about business continuity and genuine care for customers and partners. Levels of detail have varied, with some insurers (often in agent communications) addressing coverage issues and policy language that may come up in discussions with policyholders as a result of COVID-19.

The information below, however, focuses specifically on claims.

Some insurers have indicated that they are doing exterior inspections only and will not rely on interior inspections, at least for now. For some policy types, there may be a requirement to schedule interior inspections later.

Several insurers are suspending cancellations of policies due to nonpayment of premium and will not charge late fees. They generally indicated that this is a grace period and not a waiver, which likely means that any claims filed for dates of loss during the grace period would require the payment of any outstanding premium.

A few insurers did reference the use of technology to reduce human interaction during the claim lifecycle. Perhaps the most frequent issue raised was updating personal information via insurer customer portals. While this may not seem exciting or cutting-edge – and in the world of claims technology, it certainly isn't – it's probably the most important point an insurer can make to its customers right now. Such information is fundamental to initiating digital engagement throughout the claim lifecycle. There was also mention of using other digital tools and virtual inspections. For auto claims, photo apps were referenced somewhat frequently.

Runoff: The Future Starts Now

There's a lot more to runoff than UK motor these days, and that's primed the market for what's likely coming next. Even before COVID-19, there was an expectation that several market factors could cause the runoff market to grow, taking it from a risk-transfer tool of last resort to a strategic risk and capital management alternative. Now, with a pandemic leaving the market fearful of silent pandemic, an unknown impact on the workers compensation market, and a general sense that there's just more to come for the global re/insurance industry, there's a growing belief in the global re/insurance market that conditions related to COVID-19 will provide considerable fodder to the runoff market across several classes of business.

First, let's take a look at where the runoff market was headed earlier in the first quarter. Brokers had plenty of business to keep them busy, with a wide range of lines of business represented. At the Artemis ILS NYC 2020 conference in early February, runoff was brought up as more than just an exit for insurers with difficult books. The possibility that runoff could become a strategic risk and capital management tool was raised (learn more at https://www.artemis.bm/conference-reports/). Insurers could change their perspective on claims from full lifecycle to a specific time horizon (such as 5-10 years), at which point they could seek a runoff partner to pick up the business – freeing up capital and resources for new (and presumably higher-potential) opportunities.

Think about it: Once an insurer has handled the first cohort of conventionally more manageable claims in a long-tail line of business (those that close earlier), it could then exit the book and leave the more difficult effort to another entity.

Conversations with some of our market sources indicated that the natural claim "ownership" chain would progress from the original insurer writing the business to specialist runoff shops with the expertise to manage the claims more effectively. For the original insurer, the earlier divestiture of claims to runoff could mean an overall reduction in LAE associated with long-tail business claim handling.

In this scenario, "early" is everything. The original insurer would benefit most if it could truly hone its first notice of loss (FNOL) capabilities to have a strong indicator of which claims would settle most conventionally. That would enable the original claims team to manage its investment in the lifecycle for, with the notion that it could reduce overspending on claims that would subsequently be candidates for runoff. Additionally, early fraud detection would be crucial for the original insurer's claim team, with deeper investigation likely becoming the domain of both original insurers and specialist runoff shops (particularly if they develop fraud specializations). For example, conventional personal lines fraud (e.g., UK motor) would likely remain the domain of original insurers, while complex general liability or workers compensation schemes may wind up with specialist runoff operations. (As the runoff market itself develops and grows, partnering with claim fraud analytics organizations should become a competitive advantage.)

The determining factor of whether an insurer keeps or sells a block of claims, manages claims overhead, and invests in specialist capabilities will be cost. And this is a theme that will probably be magnified throughout the claim and runoff lifecycle – with the runoff divestitures (including from one runoff shop to another) potentially reshaping the standard “life of a claim” profoundly. (If you want more information on what the life of a claim looks like today, give us a shout, and we’ll connect you with the right folks at Verisk.) Remember: By the time a claim winds up in runoff, the premium is gone. No more revenue is coming in. The only lever is to manage the cost downward. And the equation involving the payment and LAE can be a difficult one to balance. A long-term sustained investment in claim-handling capabilities requires the sort of ongoing cost savings to justify it, while reduction in overhead provides a low-cost foundation from which to start but little in the way of competitive edge, or even opportunity to optimize the claim lifecycle.

In the end, the last and most stubborn of the claims would wind up with runoff firms that specialize in much older claims.

So, let’s assume the end state – before COVID-19 – is a market in which original insurers strategically divest some amount of claims around 5-10 years from FNOL, which a chain of specialist runoff risk-transfer exercises to follow, until they eventually wind up at the collection of specialist firms that focuses on truly late-stage runoff. To reach that point, it’s safe to expect a certain amount of growing pains.

The analytical workload associated with the significant increase in runoff deal flow that this end state implies would be profound. Not only would it be orders of magnitude greater than what the runoff market sees today, it would require the sorts of industrywide data sets and analytical capabilities that just don’t exist in the runoff market today. At present, , deal teams may wind up flying at least partially blind.

Of course, larger runoff shops (and those associated with larger re/insurance entities) may be able to draw some perspective from in-house data sets, and doubtless there will be some broker data flying around. However, it will take time for independent sources and analytics to evolve – not to mention best practices for using them. In the end, we believe that invention will catch up with need, although there could be some rough spots along the way.

So, what does all this mean in the COVID-19 context?

First, the original market dynamic won’t disappear because of the pandemic. It may lose some momentum while immediate challenges are addressed across the global re/insurance industry. But, opportunities to improve strategic risk and capital management always find a way of coming back. Additionally, there’s a growing view that COVID-19 could result in some additional runoff deal flow, which should come as little surprise.

COVID-19 has had a significant impact on the global re/insurance industry – and that’s even before you dive into such re/insurance industry concerns as “silent pandemic” in property policies, the risk of courts ruling that business interruption can be triggered without physical damage, and increased threats for lines of business ranging from cyber to strike, riot, and civil commotion (SRCC).

The most immediate impact, of course, appears to have come to the asset side of the balance sheet. Global financial markets have responded to the uncertainty associated with the pandemic, along with clear threats to consumer spending, contemplated changes in fiscal and monetary policy, and severe reductions in large sectors (such as transportation, luxury, and travel and leisure).

Asset-side impairment results in reduced ability to write new business, and to make matters more challenging, let's not forget that continued Irma creep could result in further erosion to re/insurer financials. Even if 2020 winds up being a fairly gentle catastrophe year, the re/insurance industry still faces a period of potentially significant difficulty.

There's a very real possibility that, by the end of the year (which is also the annual reinsurance renewal season), some lines of re/insurance business will be under considerable strain. The combination of asset-side impact, past losses and new ones from COVID-19 (whether expected or not), and the general effects of reduced consumer spending could require a wide range of re/insurers to consider a new set of strategic alternatives. Some will want to divest underperforming business in order to position themselves for a recovery. Others may have to sell off blocks of claims more urgently. Either way, the ingredients are there for a considerable runoff deal pipeline to emerge.

It's still very early days for the COVID-19 pandemic, which makes the implications for the re/insurance industry extraordinarily difficult to predict. However, it's best to be prepared for the challenges and opportunities that may arise. With this in mind, our early thinking on what the potential runoff landscape could look like as a result of COVID-19 includes:

- Portfolios and companies that were already distressed and would wind up in runoff anyway
- Additional deal flow form insurers whose books would have been stable if not for asset impairment or other performance issues
- Portfolios with lines of business that are sensitive to recession and other strained economic conditions (such as workers compensation and D&O)
- Adverse regulatory or legal developments that overturn insurance contract language to benefit original insureds – such as the requirement that business interruption be paid, even if there isn't the necessary physical damage to require it.
- 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)
- Runoff deal flow from the general consolidation trends that result from periods of widespread uncertainty.

There's a bit more in that list than you'd normally find on a runoff pipeline spreadsheet. If that actually comes to pass, then there could be much more opportunity than usual in the runoff market, which would require the swift mobilization of capital to absorb it. Assuming that the necessary capital could be raised, and that some of the opportunity winds up in the traditional reinsurance market rather than in the runoff space, the remaining challenge would be to understand the portfolios being offered up for sale.

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.

UPDATE: Silent Pandemic

There's a lot we can learn about silent pandemic from silent cyber. In 2017, NotPetya caused nearly US$3 billion in insured property losses, despite being a cyber event. Most of it came from two property programs: Merck and St Gobain. In neither case did insurers think they'd have to pay property claims from a cyber event, but the wordings ultimately favored the insureds. With COVID-19, we face a similar situation. Many companies are likely to be affected. In most cases, the re/insurance industry believes that infectious disease is excluded.

However, we have several recent events – in addition to NotPetya – of cases where re/insurers thought that an exclusion would protect them. Wildfire liability and strike/riot/civil commotion in Chilean catastrophe programs. You can even see bits of this issue in reinsurance claims from the Turkish terror event in 2016 (PCS Turkey 1613).

When a company has a large economic loss, they tend to look to the program they have that has the most limit. That's usually property. This probably comes as no surprise to anyone reading this update. If COVID-19 causes sufficient damage to drive that sort of behavior again, then it seems likelier that insureds will try to find any way they can to accumulate enough physical damage (PD) to trigger business interruption (BI). When you think about the larger programs in the market – around $250 million in limit and higher – the insureds have enough moving parts to make those PD targets presumably more attainable.

Again, look back to the NotPetya losses from 2017. We've recorded four with insured losses of at least US$200 million in PCS Global Large Loss. From the Chilean riots, we have one more above US$200 million and three more approaching US$100 million (Cencosud,Falabiella and Ripley).

According to the clients we've spoken with, the issue is unlikely to become systemic. Rather, a limited number of such claims could be able to slip through. It seems unlikely, at least at present, that a "formula" could emerge for breaching PD in large property risk programs. PCS will continue to monitor the situation and report any relevant losses via our PCS Global Large Loss platform.

Reporting Disparities among COVID-19 Data Sources

REVIEW: PCS has kept track of reported U.S. cases from several sources as a way to help the market understand any basis risk or reporting agency risk issues that could come from the use of pandemic parametric triggers in the future (you can find a good definition of "parametric" at https://www.artemis.bm/library/what-is-parametric-insurance/). Historically, the parametric market for pandemics has been relatively small, and the WHO has been the standard for reporting such information as cases and fatalities. For more background on the analysis below, please review prior PCS information-only bulletins on COVID-19.

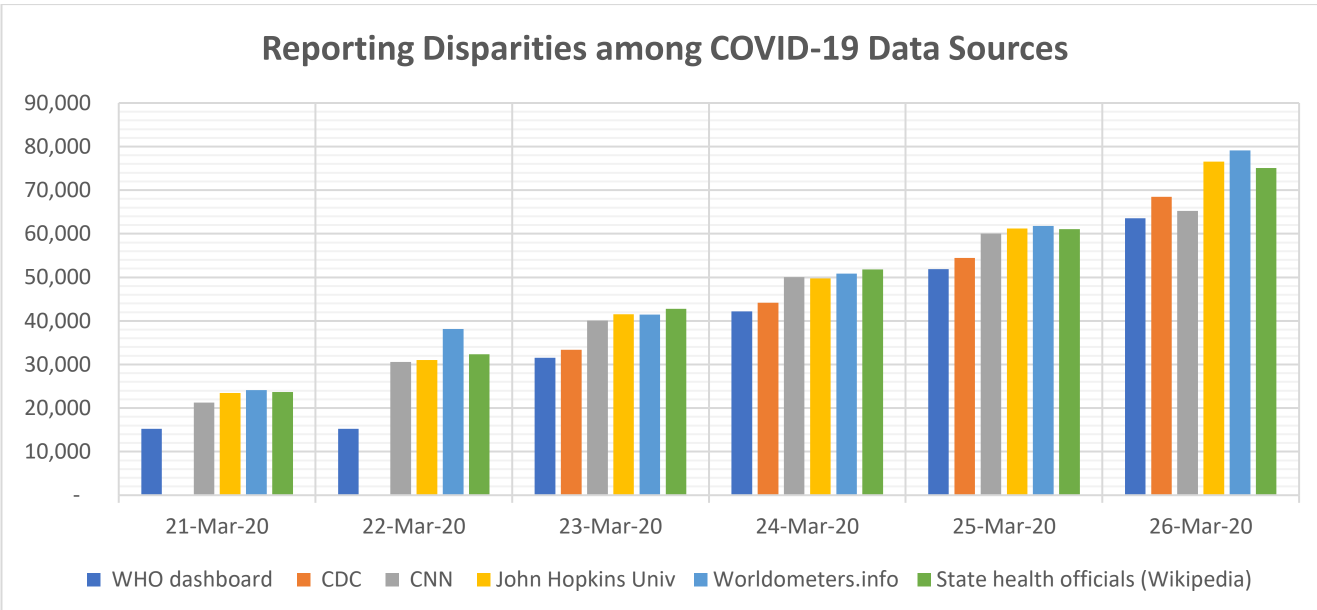
We've found that there are some structural issues that lead to reporting disparities in other regions, as well. This doesn't come as a surprise, given that the issues that introduce friction into the data supply chain are not unique to any one country:

- Test availability: Without access to tests, you can't confirm cases. At a minimum, this contributes to a lag in confirmed cases, as it takes time to get people tested, and it could also result in underreported cases, as some people may see lack of availability as a barrier to getting tested at all (and thus not bother). We believe this has been an issue in the United States, among other places.

- Sheer number of affected people: This comes to mind in Italy. It could be the case that unreported cases are much higher than what has made it into any publicly available credible estimate because the system has been overwhelmed. We believe that some cases won't be confirmed at all because of this, and also that there may be some big lags in reporting.
- Political factors: Again, this will be an issue in any region that's affected. Different countries may have different reasons for managing the flow of data into official reports that ultimately flow up to the likes of the WHO. So far, political factors appear to have slowed the progression of data into the global "machine" which has kept everyone at something of a perpetual lag. We believe this is unlikely to change. Further, it provides some basis risk into parametric transactions, as there's the possibility that a transaction could expire before underlying data catches up to the official WHO results that would be used to trigger coverage.
- Operational and production factors: The aggregation of data from underlying sources that have different reporting cycles can lead to significant lags in reporting. For the United States, for example, data would have to get from state and local health agencies to the CDC to the WHO. Timing alone can lead to a lag of several days. Timing plus the factors above can have a profound impact.
- Overall, we're still in the early days of COVID-19. Approximately 70 percent of COVID-19 cases are still active. And that rate could go up as confirmed cases may increase faster than existing cases are treated. We believe there's still a lot to learn about global and local case reporting processes. These lessons may become more important throughout the year, particularly if parametric hedges for later in 2020 become necessary and more widely adopted.

Because of all the factors that can affect reporting from case confirmation to the WHO, we have found that the deltas are not linear and can vary by country/region, reporting agency, and where they are in the COVID-19 transmission cycle. And we believe that other issues, such as workload issues at the agencies (to include the individuals responsible for updating websites) potentially make the lags even more irregular.

U.S. Reported Cases

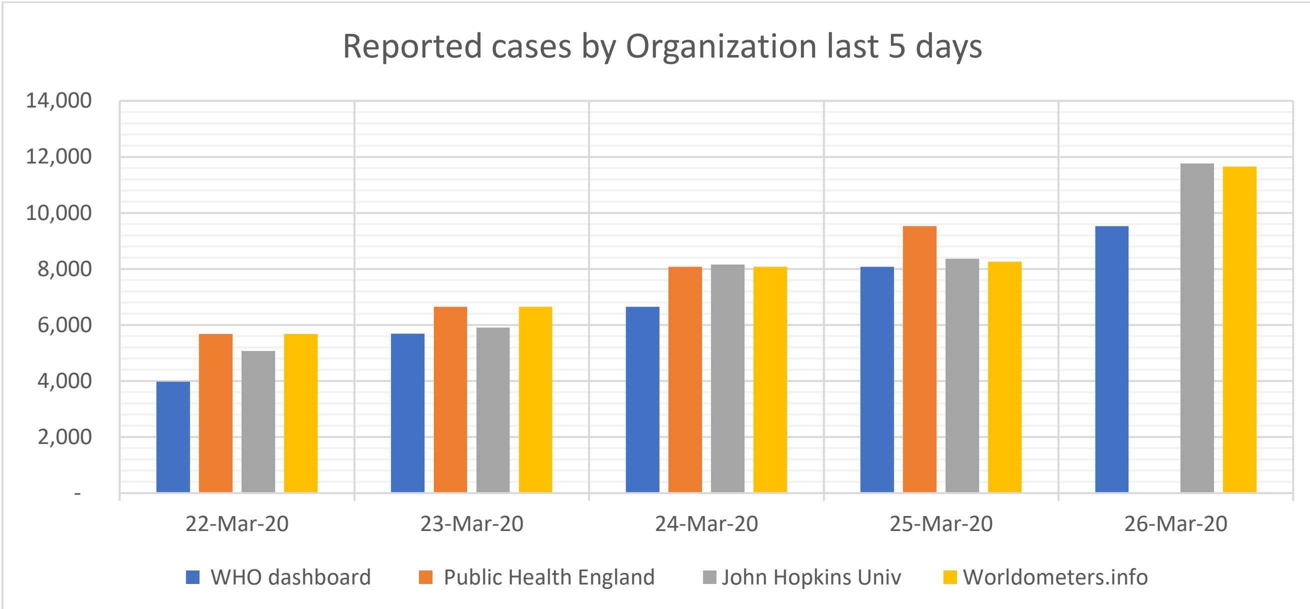


1. The most up-to-date case counts will come from states; CDC officials have said
2. CNN's tally relies on state totals and won't always match the CDC's count
3. John's Hopkins dashboard thus far has been found to update several times a day https://coronavirus.jhu.edu/map.html
4. Worldometers.info – web scraping took - https://www.worldometers.info/coronavirus/country/us/

U.S. reporting remains largely disjointed, although the differences among reporting agents is starting to narrow in places. The WHO and CDC looked like they were converging, although we suspect that issues such as testing backlogs/availability, political factors, and speed of transmission will always yield a certain amount of difference between them, and that difference will widen during times of accelerated increase in reported cases. For the reporting sources at the higher end, similar issues may be in play. New agencies may become more or less reliable based on the frequency of reporting as influenced by news cycles and other stories that are competing for newsroom resources (particularly true in a presidential election year).

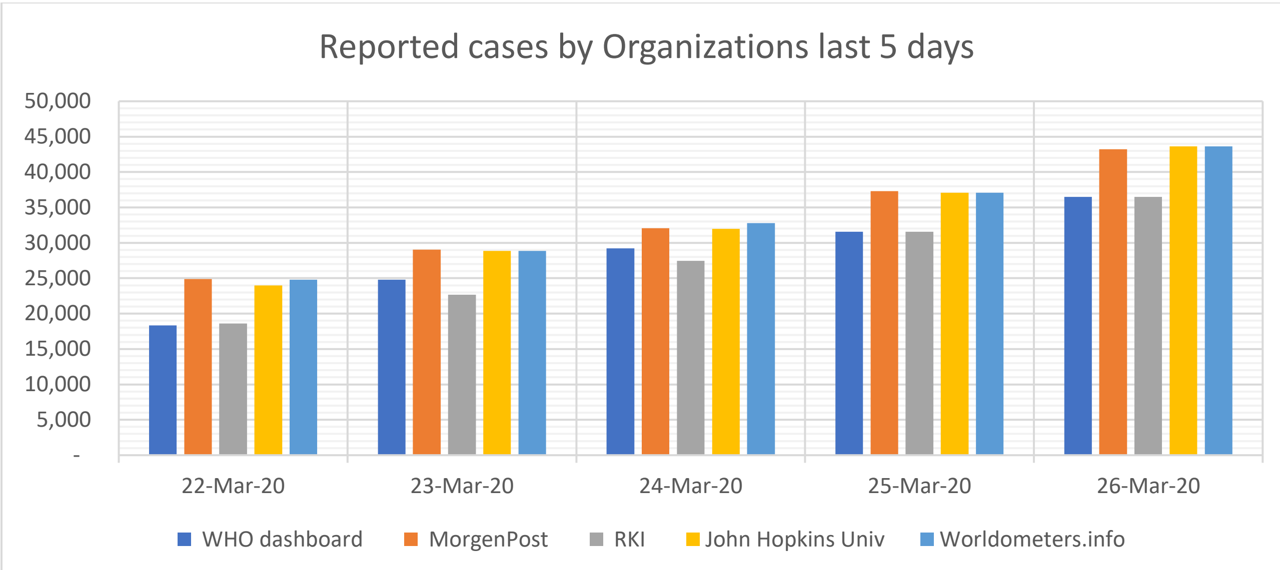
It seems as though the acceleration of confirmed cases reported in the United States – especially in locations where cases are most concentrated, like New York – could impact the flow of data to the CDC and WHO. For the structuring of future risk-transfer transactions, it's important to note the impact that a pandemic overwhelming a location (and related agency) can mean for reporting. In particular, the lag associated with untested and to-be-confirmed cases can lead to spikes in reporting, but also the factors listed at the beginning of this section can result in the delay in known data working its way through the global reporting system, as our charts have shown throughout our coverage of this process.

UK Reported Cases



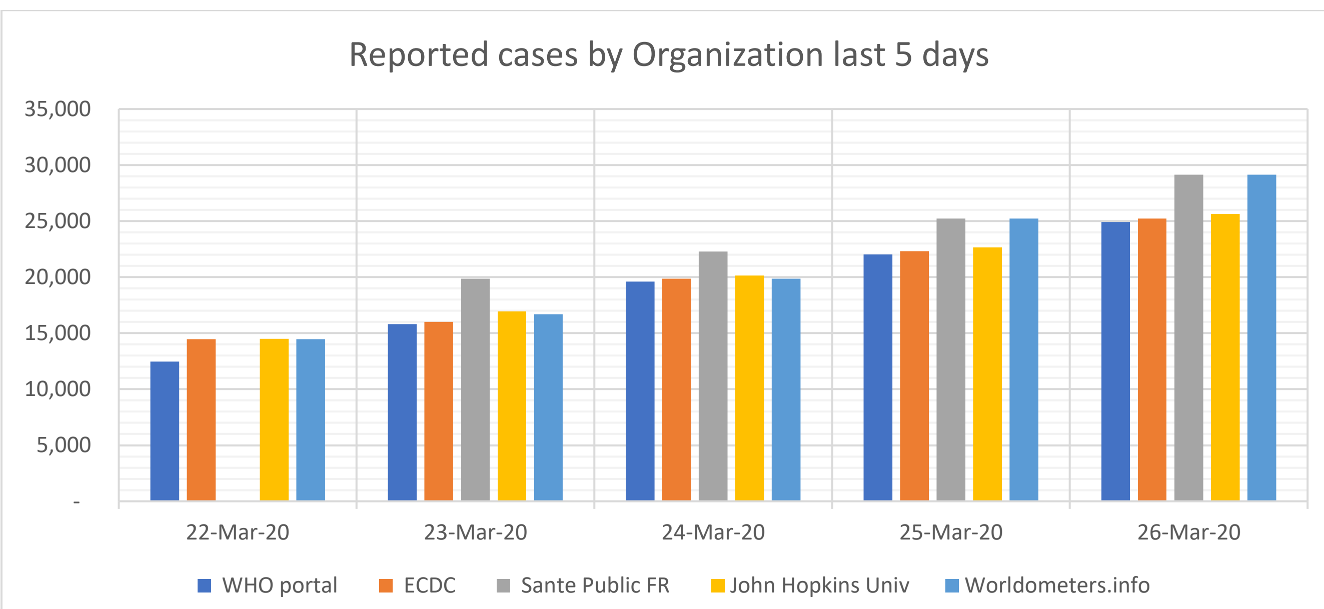
It looks as though public reporting for the UK has converged around two standards: the more conventional reporting sources and major public sources of information. This is likely because information is being shared/borrowed/used within each of these two verticals. Public Health England appears to be feeding the leading-edge data sources, with the WHO and ECDC operating in parallel. Most news sources seem to pull from established "official" data sources like Public Health England. This differs from the United States, where news sources have been able to get in front of official nationwide numbers by looking at underlying health agencies, but that is likely a function of the fifty states having wide latitude to act independently.

Germany Reported Cases



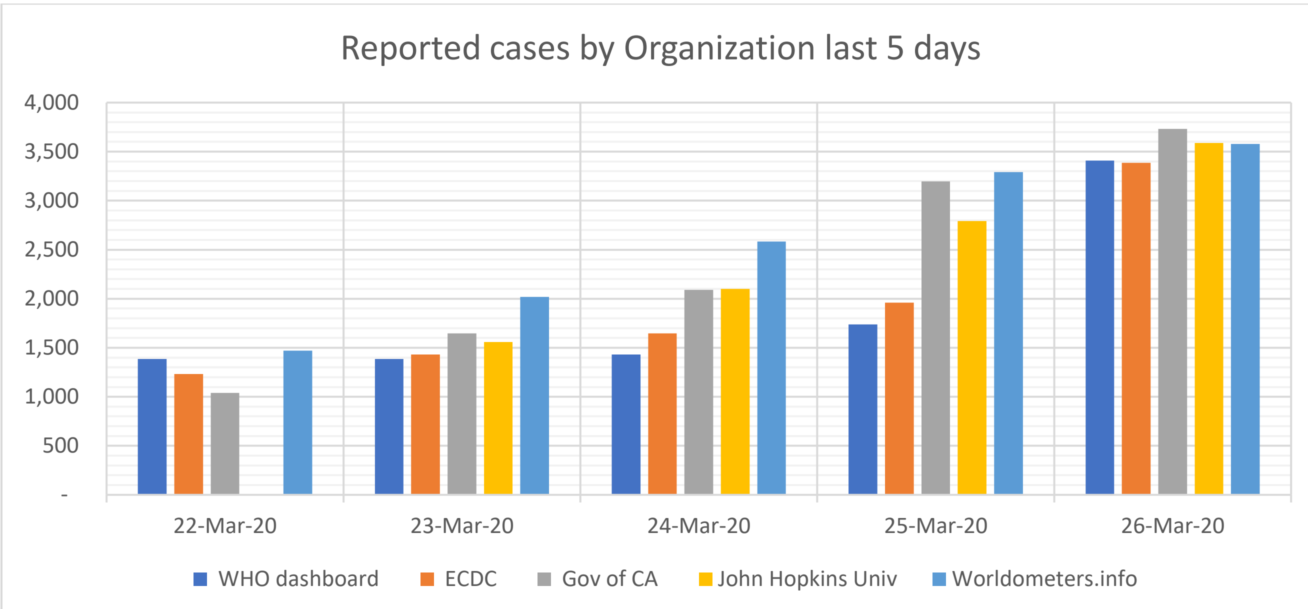
In our initial view of confirmed cases in Germany, we see consistency across RKI and WHO, although news and non-governmental sources of information are a bit higher. However, the gap has narrowed over the past several days, despite the increases being recorded. PCS will continue to monitor Germany to see how the reporting evolves in the near future.

France Reported Cases



After some small reporting gaps, WHO and ECDC have aligned, although the differences between them were generally minor. Santé publique France appears to be the highest and presumably authoritative data source in France, although it isn't wildly ahead of the other data sources.

Canada Reported Cases



Reporting sources appear to have caught up with the government. PCS will continue to monitor for now, although we may focus on other regions if the data remains consistent.

We're beginning to review new regions to include in this analysis and have been monitoring the increase in confirmed cases in Spain particularly closely (https://covid19.isciii.es/). We've seen a rapid increase in the number of cases there and are also beginning to watch Germany more closely, as well.

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

While we're still very early in the process, indicators are that the Olympics may be a partial loss due to the postponement, as the revenue implications are not as severe as a cancelation. For other events, insured losses may be muted because of cancelations made for reasons other than government or civil mandates (such as inability to source cleaning materials, talent, or other supplies).

Update: Workers Compensation

Several insurers have provided statements to their clients and partners addressing workers compensation specifically. In general, the appear to emphasize that the specifics of workers compensation claims can vary widely, and that each needs to be evaluated to determine the appropriate course of action. While this may seem like an obvious response, PCS perceives it as a positive effort to engage the market and indicate that there's work to be done on such claims, as there would be regardless of COVID-19.

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.