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Insurance protection in covid times: myth or reality?

Prof. Karel Van Hulle
KU Leuven and Goethe University Frankfurt

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Agenda

1. The pandemic storm of Covid-19
2. Covid-19 as an example of systemic risk
3. Insurance and systemic risk
4. Takeaways

1. The pandemic storm of Covid-19

Impact of Covid 19 on the economy

- Partial or total lockdown of economic operations
  - Digitalisation - Operational resilience
  - Massive capital injections by governments
- Extreme turbulence in financial markets
  - Important investment losses initially
  - Increased volatility in financial markets
- Fear for liquidity crisis in financial institutions
  - Distribution prohibitions by banking supervisors
  - Strong recommendations by insurance supervisors to also stop distributions

Impact of Covid 19 on tourism (UNWTO)

- Lockdowns of hotels and restaurants
- Travel restrictions – lack of coordinated response
- International tourism back to levels of 30 years ago
- Estimated loss in export revenues from international tourism: 1.3 trillion US$ (- 74% of intern. tourist arrivals)
- Estimated loss in global GDP over 2 trillion US$
- Loss of international tourist arrivals: 1 billion
- Direct tourism jobs at risk: 100-120 million
- International tourism not expected to return to pre-Covid levels before 2023

Insurance implications of Covid-19

- Covid-19 had obviously consequences for life and health insurance, which could have been expected
- Not expected was the large impact of Covid-19 on non-life insurance, particularly in the areas of business interruption and event cancellation insurance
- This was not expected as nobody could have foreseen that Covid-19 would lead to prolonged lockdowns of large parts of the economy
- The damage resulting from these lockdowns was so huge that governments had to intervene in order to provide financial support for businesses which were forced to close down
- In most instances, the damage resulting from business interruption and event cancellation was not covered by insurance

Impact of Covid-19 on private customers

- Covid-19 produced a new protection gap: many customers found out that they were not protected against the damage resulting from the lockdowns (for instance, travel restrictions), although they sometimes had an insurance contract (for instance, travel cancellation insurance) which contained a pandemic exclusion clause
- Insurers often showed a lack of empathy by taking a wait and see attitude or by refusing to compensate policyholders, without suggesting an alternative solution
- Only in a few cases, insurers were prepared to partly compensate policyholders or to lower premiums in areas, such as motor insurance, where they were making windfall profits
- Regulators had to remind the insurance industry to ensure a fair treatment of customers

Impact of Covid-19 on insurers

- Direct insurance losses resulting from Covid-19 were fairly limited
- Indirect losses resulting from lockdowns have been considerable and are likely to be underestimated
- Most losses suffered by insurers resulted from market turbulence, particularly in the first months that followed the outbreak of the pandemic, and from a slowdown in the economy
- The increase in lapses or withdrawals in life insurance, which would have resulted in liquidity risk for insurers was less severe than was expected
- Digitalisation of insurance increased tremendously and is likely to stay
- Operational resilience (third party risk) and cyber risk have become major points of attention

2. Covid-19: an example of systemic risk

How does insurance work?

- Insurance is based upon a contract under which one party, the insurer, promises another party, the insured, cover against a specified risk in exchange for a premium
- Insurance relies on risk pooling, i.e. the underwriting of large diversified pools of mostly idiosyncratic and uncorrelated risks
- The insurer will have to estimate the probability of a specific risk materialising, as well as the value of that risk, which usually involves the intervention of an actuary
- The actuary will calculate the insurance liability, which reflects the expected risk, i.e. the specific risk which both parties to the contract have agreed to insure
- Calculating the insurance liability often implies (stochastic) modelling

Insurance cover

- Only those risks which are specifically included in the contract are covered by insurance
- Insurance contracts usually contain clauses, which exclude insurance cover in certain specific cases
- It is not uncommon that the same exclusion clauses appear in insurance contracts
- Since the appearance of SARS in 2000, pandemics usually figured as an exclusion clause in insurance contracts
- The wording of the pandemics exclusion clause was not the same in all insurance contracts so that pandemic risk was covered in certain cases and denied in other similar cases
- In all parts of the world but particularly in Anglo-Saxon countries, this uncertainty has led to litigation before the courts

Black swans are becoming white

- Even before infectious deseases such as SARS and EBOLA (epidemics) started to appear at the beginning of this century, it was well known that a pandemic was there to come
- Nobody did however expect that Covid-19 would lead to a total or partial lockdown of economies across the globe
- Protection by insurance against a risk that appears at once all over the world and that affects the whole economy is difficult (lack of diversification, no independent and predictable loss exposure, impossibility to manage the maximum potential loss)
- Pandemic risk can be qualified as a systemic risk, in the same vain as other risks, such as climate change, cyber security risk, etc.
- Welcome to the age of the black swans!

3. Insurance and systemic risk

Limits of insurability

- There are technical solutions for pandemic risk, such as parametric insurance: a pre-established payment to the insured upon the occurence of a specific catastrophic event
- It is doubtful that such solutions will be equally available to small businesses or at a reasonable price
- Insurance cover is not possible for events that affect an overwhelming proportion of society on a worldwide basis, because the risk cannot be pooled or diversified geographically
- In order to reduce the protection gap resulting from this, a public/private partnership solution must be developed, similar to that existing in other areas, such as natural catastrophes or terrorism
- For possible solutions, see for instance the discussion papers released by EIOPA and the Geneva Association

Public – Private Partnership solutions

- Although there is a basic agreement about the fundamental criteria of insurability (based on Berliner 1982), the borders of insurability can be increased by innovation (for instance, ART and ILS)
- Requiring the private sector to cover risks of a systemic nature, would make it impossible for the insurance sector to cover other risks
- As the public sector would eventually end up as the insurer of last resort in the case of systemic risk, it makes sense to design a regime which includes the public sector ab initio
- Requiring the public sector to contribute presupposes that all parties concerned (policyholders, insurers, reinsurers and public authorities) put skin in the game
- A PPP solution necessitates a well functioning private insurance layer with clear wording in policies and no unreasonable exclusions

4. Takeaways

Lessons learnt

- We live in a risky world and the future remains unpredictable
- Good risk management can contribute to identifying more unknown unknowns (black swans)
- Insurers should continue their role as protectors against risk and should show more empathy to policyholders (insurance is part of social science)
- Systemic risks, such as pandemic risk, are likely to increase the already existing protection gaps
- Protection against systemic risks is no luxury but a necessity and requires a well functioning insurance market (education, prevention, innovation) assisted by a public/private sector partnership where all parties concerned put skin in the game