Moving on from the initial assessment phase of COVID-19

A Willis Re Impact Report

First Edition
23 April, 2020

Willis Re

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Preface

23 April, 2020

COVID-19 has rapidly entered the vernacular and psyche of the global population. It has impacted all our lives and broad swathes of industry. As the situation unfolds, there continues to be much uncertainty in both our personal and our professional lives.

Governments around the world have put in place various measures to control the spread, such as the social distancing guidelines with which we are becoming ever more familiar. From an economic standpoint, the G-20 has committed US$5 trillion in domestic stimulus and US$8 trillion overall in fiscal stimulus packages to support communities and businesses large and small, and central banks have cut interest rates to try to promote liquidity in financial markets, with the likelihood of more to come.

This virus affects all our daily lives, whether that be to care for vulnerable relatives or to work from home for the foreseeable future, and Willis Re colleagues face the same challenges. We are supporting our teams the world over so they can be there for their families and communities who may need their support now more than ever. Nevertheless, we are resilient and continue to work in support of our clients in helping them achieve their objectives.

The (re)insurance industry is facing almost unprecedented challenges, in terms of not only operational disruption but also financial strain on the balance sheet and an ever-deteriorating claims position that will likely lead to industry dislocation. Consequently, we aspire to provide our clients and market partners, as their trusted advisors, clear, actionable insights at industry, business-line and regional levels. Our aim is always to best serve our trading partners with bespoke advice to fit their specific business.

Our teams have been diligent in providing such an in-depth presentation, and I hope that once you have reviewed this report in full you will be better informed to meet the needs of your business and clients.

Sincerely,

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Global CEO, Willis Re

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Section 1: Executive summary

We are pleased to provide the first Willis Re report focussing on the pertinent issues developing out of the global COVID-19 pandemic affecting the global (re)insurance industry. With uncertainty in both the magnitude and breadth of impact and uncertainty over the expected time horizon, we felt it important to provide an assessment of the current landscape and how best to plan and navigate over the coming weeks and months. We will provide further updates as the landscape evolves in the months ahead; meanwhile, this report focusses on four central themes.

1. The first is an economic and financial overview of the global life and non-life (re)insurance industry, broadly concluding that solvency, while dented, remains robust at an aggregate level albeit with regional nuances. Furthermore, the industry is experiencing an unexpected increase in loss activity with events being provisionally notified to the (re)insurers. The industry is built for extreme scenarios, and while H1 operating results may make disappointing reading for investors depending in large part on how (re)insurers address the complex reserving challenges of COVID-19. From a resilience perspective, the industry continues to cope thus far, albeit with legislative threats with severe and potentially existential consequences. This can be found in **Sections 2 and 3.**
2. The second considers the impact of some shrinkage of the global industry's "balance sheet" and what that might portend in the (re)insurance supply-and-demand equation notably for capital-intensive portfolios. This can be found in **Sections 3 and 4.**
3. The third is an overview of how companies might plan for the balance of the year. Facing uncertainty on the asset side, parts of the loss side and a customer base substantially impacted by a global economic slowdown requires scenario- and forward-planning that reflects the potential impact on balance sheets, risk appetite and adjustments to external risk-financing strategy. This can also be found in **Sections 3 and 4.**
4. Finally, we have provided an initial assessment of the market dynamics by individual lines of business or specialist segments or territories where relevant. The picture is developing rapidly at a regional and often micro-segment level with a growing number of examples where coverage for business interruption was explicitly provided. For each segment the perception of exposure to COVID-19 and the scrutiny in terms of loss activity, ongoing underwriting strategy or coverage varies widely. The indirect impact across the non-life risk spectrum will vary; concerns over frequency in casualty classes are offset by significant reductions in economic activity, and in the case of Motor insurance, there are significant reductions in mileage driven. This can be found in **Sections 5 to 8.**

This overview seeks to provide guidance on the critical immediate tactical issues, how and where clients might focus, and how they can prepare for both new and renewal (re)insurance placements going into the market. This is not the chosen medium to debate the strategic issues of state versus private sector pandemic risk finance, nor is it the forum to forecast the impact of political intervention in coverage, notwithstanding that it represents significant uncertainty for the global (re)insurance industry. This will no doubt surface in subsequent editions.

In the final analysis, as the global life and non-life insurance industry's secondary market, the reinsurance industry plays an essential role providing surrogate capital to manage volatility, which presently has enhanced value. With stress points possible in periods of uncertainty, we urge all parties to retain focus on their long-term requirements where they may need to work out issues. Opportunistic or capricious behaviour is unlikely to be rewarded as history consistently confirms that balanced and reasonable behaviour during uncertain times has defined standing and enhanced franchise value.

While this report is current as of the time of publication, the situation is fluid; for that reason, we aim to provide an update as the situation dictates.

Section 2: Introduction to COVID-19

Novel coronavirus: COVID-19

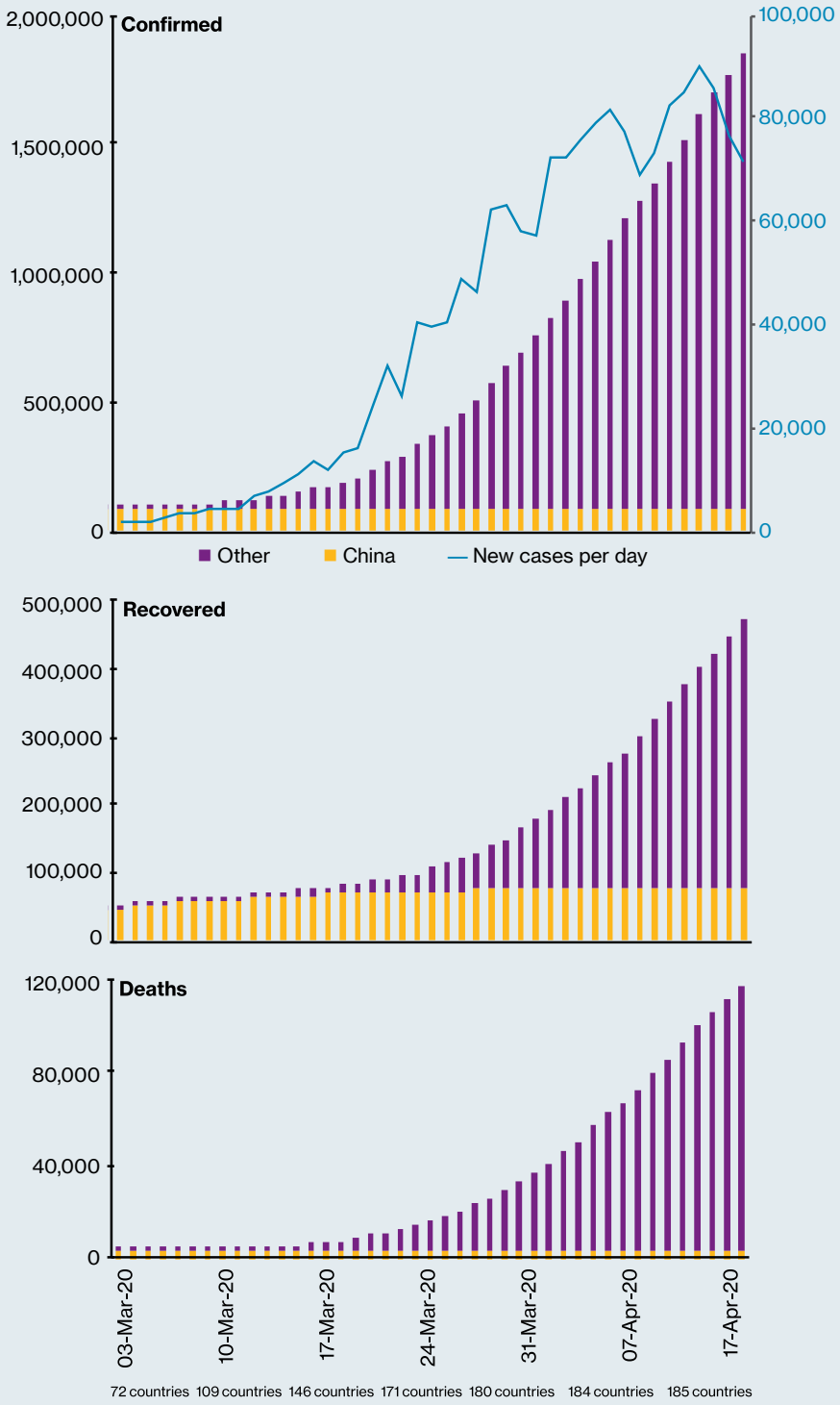
Background and context

On 31 December 2019, Chinese officials notified the World Health Organisation (WHO) of several cases related to pneumonia in the port city of Wuhan in the Hubei province in China. At the time, it was unknown that this was the beginning of what was shortly thereafter referred to as the novel coronavirus, or 2019-nCoV as it was called then, or COVID-19 as it is now. COVID-19 belongs to the coronavirus family, which also includes severe acute respiratory syndrome (SARS) and the common cold.

On 11 March 2020, WHO characterised COVID-19 as a pandemic, mentioning concerns about the alarming levels of spread, severity and lack of action. WHO, the United Nations Foundation and partners launched the COVID-19 Solidarity Response Fund on 13 March to support the work of WHO and partners in helping countries to respond to the pandemic.

Europe was declared as the new epicentre of the pandemic by the WHO director-general on 14 March, with more reported cases and deaths than the rest of the world combined, apart from China. Since then, the number of confirmed cases and the rate of increase in the US has propelled it to the top of the table. Much of the world has instituted social distancing measures intended to curb the transmission of the disease.

Also, as at 16 April 2020, the official number of confirmed infections globally was 2,432,092, with deaths representing 166,794 of these. More up-to-date information can be found on the Johns Hopkins University website: https://coronavirus.jhu.edu/.



Source: World Health Organisation, raw data from CSSE Johns Hopkins University, Willis Re (15/04/2020)

Economic impact

As the human cost unfolds, current reports describe the global economic impact as an unprecedented event when considering the compounded effect of the virus and the scale of action taken as preventative measures.

> *"The global economic picture is looking bleak, with recessions in almost every developed economy across the world. We assume that there will be a recovery in the second half of the year, but downside risks to this baseline scenario are extremely high, as the emergence of second or third waves of the epidemic would sink growth further. At this stage, it is also hard to see an exit strategy from the lockdowns, which means that uncertainty will remain high. Finally, the combination of lower fiscal revenues, and higher public spending, will put many countries on the brink of a debt crisis."*[1]

Recent statements from the International Monetary Fund (IMF)[2] confirm the inherent uncertainty as they describe being "faced with extraordinary uncertainty about the depth and duration of this crisis" but that "it is already clear, however, that global growth will turn sharply negative in 2020, as you will see in our World Economic Outlook next week. In fact, we anticipate the worst economic fallout since the Great Depression."

The IMF continued, "Just three months ago, we expected positive per capita income growth in over 160 of our member countries in 2020. Today, that number has been turned on its head: we now project that over 170 countries will experience negative per capita income growth this year."

Global statistics and country analysis

All countries have faced some exponential growth in the number of confirmed cases. Asian countries have contained their growth of cases with strict and early measures when the very first cases were detected, leading to flatter curves. As of today, the US, Italy, Spain, Germany, France, the UK, Turkey and Iran have all surpassed the confirmed case count of China, and other countries will probably be faced with a similar challenge soon.

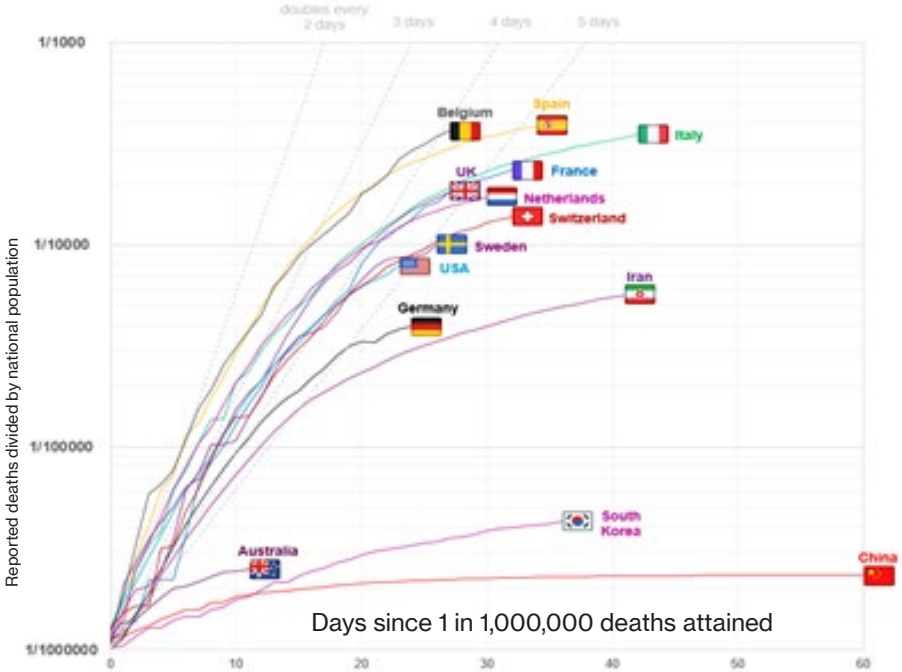
Social distancing and large-scale shutdowns are efficient mitigation measures; however, their effects are not immediate due to the kinetics of a virus spread in a population. It must be noted that China and the other East Asian countries in our study took drastic social distancing measures earlier than any western country at the same stage.

If we optimistically estimate that the confirmed case or death count is doubling every 3.5 days, then a delay of just two weeks means that a country is dealing with 16x more cases than before, as shown in Figure 1.

Figure 1. **Intervention measures by country**

Global travel restrictions helped in delaying the spread of the virus, offering countries outside of China time to prepare. However, new clusters have formed and developed rapidly, as we can see in Figure 2.

Figure 2. **Reported deaths globally**



Source: raw data from CSSE Johns Hopkins University, Willis Re (15/04/2020)

[1] Agathe Demarais, the Economist Intelligence Unit's global forecasting director
[2] https://www.imf.org/en/News/Articles/2020/04/07/sp040920-SMs2020-Curtain-Raiser

Potential scenarios

Significant uncertainty in the future trajectory of COVID-19 and its impact on the insurance industry warrant a measure of scenario setting and testing. There are several historical events that could be used to approximate the current societal impacts and others that can be used to approximate the impacts on financial markets. What does not currently exist in this set of scenarios is one that mimics both the societal and financial effects, so a certain amount of interpretation will be required, and the four Willis Towers Watson (WTW) scenarios outlined in Figure 3 – optimistic, mild, severe and extreme – help with this. It will likely be useful to contextualise the ongoing COVID-19 outbreak in relation to these events.

The WTW scenarios have been developed using epidemiological science and can be summarised qualitatively as below. The very nature of COVID-19 and the events listed here mean that direct comparison is complex. Nevertheless, the impacts can possibly teach us something about the ongoing situation, which may assist in informing the tactical decision set facing the industry at the current time.

The health and economic outcomes in each of these scenarios are interlinked. For example, the first three scenarios involve strong social distancing measures which have significant impacts on economic activity and unemployment throughout the developed world (discussed later in the Economic Scenarios section) but are also able to improve the health outcomes to differing extents. As the spread of the virus reduces, the social distancing measures are also gradually loosened to enable the economy to recover. However, it is also possible that the virus continues to spread despite initial social distancing efforts, and uncontrollably when control measures are prematurely lifted

Figure 3. **WTW four scenarios of COVID-19 future trajectory**

Type	Proxy events	Confirmed cases	Confirmed deaths	Duration (years)
Social	1918 Spanish flu	500M	17M –100M	3
Social	1957 Asian flu	Unknown	1M – 4M	2
Social	2002 SARS	8,000	800	2
Social	2019 COVID-19: WTW scenario #1: Optimistic	6M	540,000	0.5
Social	2019 COVID-19: WTW scenario #2: Moderate	390M	3M	1
Social	2019 COVID-19: WTW scenario #3: Severe	1.2B	10M	2
Social	2019 COVID-19: WTW scenario #4: Limited Success	5.9B	96M	Unknown
Economic	1929 Great Depression			3.5
Economic	2008 Global Financial Crisis			1.5

('Limited Success' scenario). We have not associated probabilities with these scenarios, but we regard all of them as possible and at this point should not be considered tail scenarios (although some of them may have been before the COVID-19 outbreak).

Optimistic

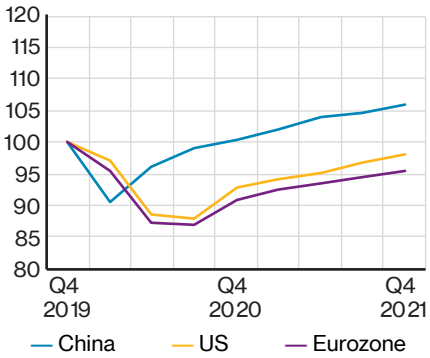
Strong social distancing programs and medical research are effective in reducing the spread and severity of the disease relatively quickly. The world experiences an overall 6 million reported infections 540,000 deaths, during two months of stringent lockdowns and one month during which restrictions are lifted gradually.

Moderate

Social distancing and lockdowns help to reduce the spread of COVID-19 gradually over a period of six months, until both medical advancements and long term societal improvements in areas such as hygiene are able to keep new infections to a low level. The world experiences an overall average 5% infection rate and a 0.8% average Case Fatality Rate (CFR). That implies 390 million infections worldwide and 3 million deaths. The pandemic lasts through to the end of Q3 2020.

This scenario would bring a more severe shock to global GDP and, whilst China's economy would recover relatively quickly consistent with the progress being made against fighting the virus itself, the US and the Eurozone would likely feel the effects of COVID-19 for a few years, until GDP eventually recovers to pre-pandemic levels.

Figure 4. **WTW moderate scenario**



Level of real GDP
Index, 2019 Q4 =100

Severe

Similar to the moderate scenario, except that mitigative actions are slower and less effective. Lockdowns are in place at varying levels of severity for most of 2020, as governments attempt to balance mitigation of economic damage with the ability for healthcare systems to manage severe infections. The result is a global spread in which 15% of the population is infected, with a 0.8% average CFR. Globally, this implies 1.2 billion infections and 10 million deaths.

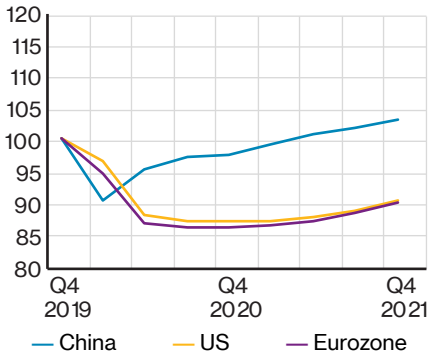
This scenario estimates a 15% shock to the GDP of the US and the Eurozone, with only a small recovery over the next few years. Economic output does not return to pre-pandemic levels until beyond 2023. It is worth noting that this represents a 'best-case' economic possibility for the severe scenario, which could provide a starting baseline.

The epidemiology suggests a 12-month lockdown with two potential severities:

- A milder version, being intermittent and/or localised in nature
- A more severe version, implying permanent and national lockdown

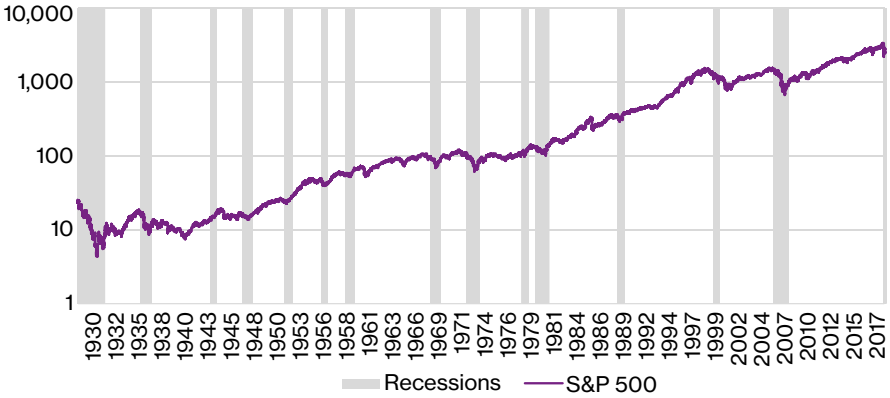
The economic scenario outlined in Figure 6 would correspond to the first of these sub-scenarios, with the expected outcome for the second looking more like World War II or Great Depression-type economic impacts.

Figure 5. **WTW severe scenario**



Level of real GDP
Index, 2019 Q4 =100

Figure 6. **S&P 500 historical values with recessionary periods**



Source: Yahoo finance data

Limited success

While strong social distancing programs have some impact on controlling the pandemic, the disease resumes spreading rapidly when controls are lifted. Controls are ultimately abandoned after four months due to the catastrophic economic impact and the spread eventually slows as a result of global herd immunity.

The extreme scenario has a 76% infection rate and 1.6% average CFR, implying 5.9 billion infections and 96 million deaths across the global population.

ICT has also developed a probabilistic pandemic scenario model leveraging expertise from our Climate and Resilience Hub. For a complete set of reports provided by Willis Towers Watson for insurance company clients, please visit [https://www.willistowerswatson.com/en-GB/Insights/2020/04/covid-19-willis-re-impact-report].

Initial conclusions

COVID-19 is not close to peaking. Public health policy to "flatten the curve" enables health care systems to moderate the influx of infected patients with the consequence of extending the length of the pandemic. The societal and economic impact has weeks if not months to go, thus deepening the severity of the impact and delaying the start of any recovery and return to pre-COVID-19 status. Juggling public health and economic impact may well result in some adjusted societal guidance in an attempt to encourage economic activity, but it will be some time before a return to the so-called normal.

For insurers this raises planning issues that must consider how best to navigate the uncertainty adopting the cliché of hoping for the best but planning for the worst. As 2019 ended, the forecast, with some regional variability, was for global GDP growth and fundamentally stable conditions. Q1 2020 has reversed that with GDP collapse, asset-side volatility and emerging insurance losses, none of which can be relied upon to disappear in the immediate term.

The prognosis for 2020 is unrecognisable relative to plans finalised only months ago, and the consequence of this must be that (re) insurers revise their plans, adjusting for a range of economic scenarios that will impact customer bases, investment returns and balance sheets. Many insurers may be holding more risk relative to their balance sheets than they had anticipated, which suggests three options: ride it out, de-risk, or hedge. Whatever decision leaders adopt, there is work to be undertaken to determine the landscape first and then quantify all of the internalities and externalities that will support a decision in one direction or another.

Section 3: Economic effects of COVID-19

Financial impact of COVID-19

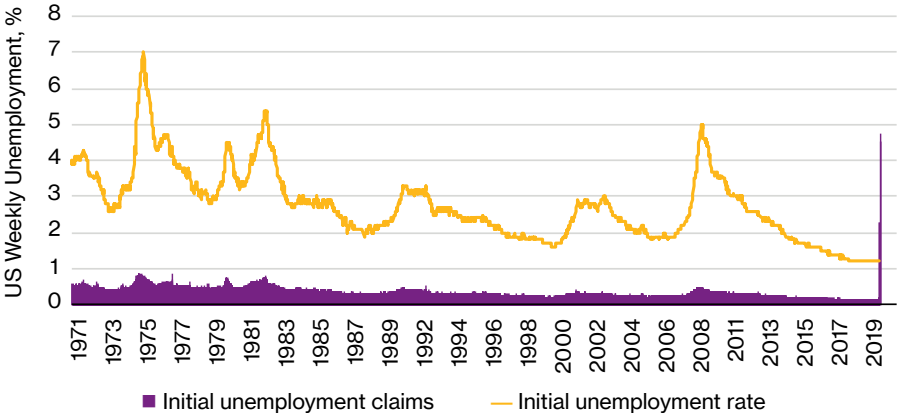
Macroeconomic effect

Governments across the world have instituted measures to mitigate as best they can the spread of COVID-19. Measures such as social distancing are now common, and in many instances, this extends to temporarily closing large sections of society and industry, including but not limited to:

- Schools
- Entertainment venues
- Sporting events
- Industrial manufacturing
- Hospitality: hotels, bars, restaurants
- Nonessential retail outlets
- Aviation

Aside from applying downward pressure on stock markets, unemployment levels are rising sharply, particularly in the US. Governments have put together large fiscal stimuli to ensure there is not a repeat of the credit crunch that exacerbated the severity of the last recession during the Global Financial Crisis in 2008. Monetary policy from central banks has also reacted by cutting interest rates close to zero. The People's Bank of China cut the interest rate in China to 0.1% on 16 February 2020, and on 15 March 2020 the Fed cut the US benchmark interest rate to 0%, with further cuts not ruled out.

Figure 7. **US unemployment and Initial Claims Rate, 1971 to 2020**



Source: BLS, U.S. Department of Labor

Fiscal stimulus packages for major economies

Economy	Amount (USD)
US	2.2 trillion
European Union	820 billion
UK	400 billion
Australia	114 billion
South Korea	80 billion
China	80 billion

Source: The Guardian (US), New York Times (EU), Financial Times (Australia, South Korea, China), The Telegraph (UK)

Capital and solvency of the reinsurance industry — asset side

The reinsurance industry has, thus far, proven that the systemic shock delivered by COVID-19 appears to be manageable; however, the robustness and future health of the sector will depend on the severity of the emerging health scenarios and longevity of the various national governmental actions and their associated impact on their respective economies. Enough buffer capital has been built up over the recent relatively benign loss period for extreme asset-side events such as this. The extent to which the industry can withstand the volatility in equity markets over a longer period remains to be seen; however, the immediate period of flux is slowing down.

Risk-free rates are moving toward zero and are already in negative territory in many countries. The industry is going to have to manage this evolving picture in the short to medium term. So far, participants in the industry have started to de-risk their balance sheets, holding cash for the time being. This will feed through to a significant impact on investment returns, to the detriment of the bottom line. Asset allocation more generally will evolve over the coming months, and later editions of this report will cover any new developments as and when they arise.

US stocks across all industries have faced a major market sell-off –– the largest seen since the Global Financial Crisis – driving the major US indices 28% to 35% lower in a matter of days. In recent weeks, however, they have rebounded and at present sit about 15% below their year-end-2019 levels. The exact rationale for the rebound is unclear, but government stimulus packages and interest rate cuts will certainly be major factors. Other factors that may offer confidence to investors – such as the non-critical leisure and hospitality sector restarting operations, or health care companies edging closer to finding a vaccine – are less likely to feature at this stage of the outbreak but could play a bigger part in the recovery over the coming weeks and months.

Factoring in the year-to-date moves in equity, credit and treasury markets, our current estimated hit to the global reinsurance capital base is approximately 5%, or US$30 billion pretax. Illustrating how volatile the situation is, this estimate had been 20%, or US$110 billion, as of late March. Rating migration and/or defaults on corporate bonds could put additional pressure on solvency, and the decline in interest rates will be an additional negative for some.

However, strong starting points of capital strength provide insulation, and importantly, the reinsurers with the greater sensitivity to investment market volatility tend to be the ones with the stronger current credit ratings and solvency levels.

In the medium to long term, there is an impending threat of recession – some even go as far as calling it a certainty during 2020. News outlets such as the Guardian are quoting JP Morgan[3] to that effect and Bloomberg's[4] US recession tracker is currently at 100%. The questions that remain are, How deep could a possible recession go and how long might it last?

[3] https://www.theguardian.com/business/2020/apr/06/coronavirus-means-a-bad-recession-at-least-says-jp-morgan-boss
[4] https://www.bloomberg.com/graphics/us-economic-recession-tracker/

Insurance industry stock prices

Reinsurers are typically considered to be at the defensive end of the global insurance sector (that is, they should go down less than the overall insurance sector when markets are falling); life insurers are at the other end of the spectrum; however, as Figures 8 and 9 show, the recent sell-off has been the other way around: Willis Re's global re index is down 30% year to date versus a 23% decline in our global insurance index.

Direct claims impact manageable...so far

The consensus appears to be that claims themselves are likely to be manageable from the standpoint of the sector's financial strength. The insurance trade press has estimated that event cancellation claims could produce insured losses of US$4 billion to US$6 billion. Assuming most of these fall on the reinsurance sector, this would be equivalent to a midsize hurricane, and about 1% of the global reinsurance sector's capital base (US$559 billion, from Willis Re's half-year 2019 reinsurance market report). Focus is also drawn to credit risk, specifically whole turnover (or structured) trade credit, surety as well as mortgage insurance. These classes were initially identified as the more exposed classes through the early part of March, although attention quickly turned to the amount of coverage available in primary policies for business interruption (BI) and how that might flow into the (re)insurance market.

The reserving challenges for (re) insurers – practical, operational, legal and technical – are formidable. The threat from BI is exacerbated by growing vocalism from various US state legislators seeking to revise actual coverage granted into something that they wish had been granted retroactively. This action represents an existential threat to the entire industry, never mind the consequences of unilaterally changing contract law.

Whether these US states ultimately expropriate private assets or not, it is likely that realpolitik will result in some compromise as has been seen already with the voluntary return of premiums by several personal lines private passenger auto insurers to their insureds described as a reflection of diminished exposure as vehicles lie dormant. Such actions are unlikely to be the last, and the impact on premium growth is likely to be material but presently uncertain. What it does reveal is that a sudden reduction in activity can proportionately lower exposure. Motor vehicles lying inactive are unable to crash; furloughed workers are removed from industrial accidents, and the possibility for a reduction in exposure and loss activity in liability lines remains not only possible but probable.

Figure 8. **Indexed share prices**

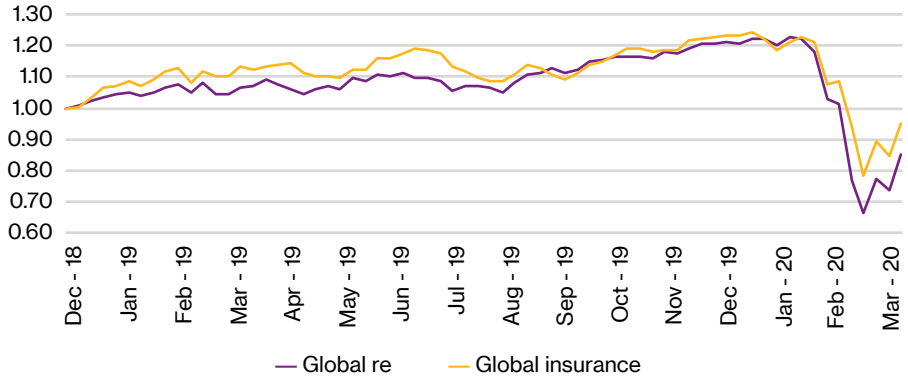
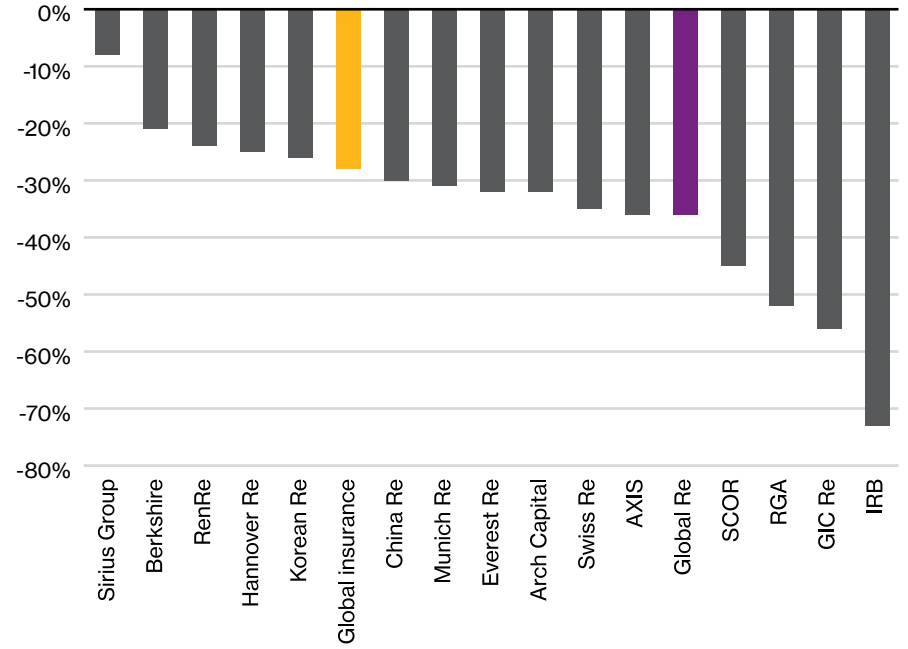


Figure 9. **Year-to-date share price change**



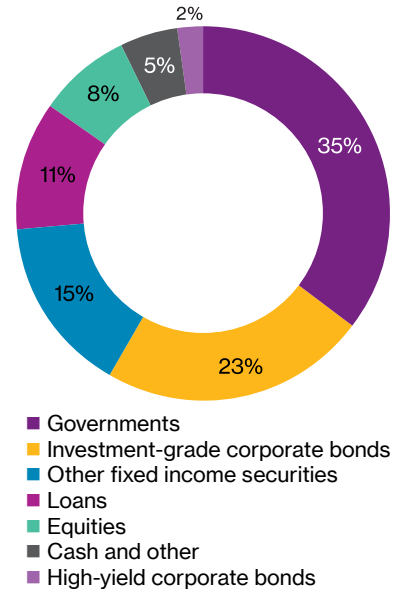
Asset-side shocks to balance sheets

Rather than potential claims, by far the more visible impact is coming from investment markets. All the following are negatives for (re)insurers' balance sheets and therefore solvency positions:

- The collapse of equity markets (S&P 500 –14% year to date)
- Widening credit spreads (ie falling corporate bond prices; US and European investment grades have recovered to be roughly flat year to date, while high yield is down about 10%)
- The increase in volatility (eg the VIX index, which hit an all-time high of 83 on 16 March)

We have analysed the balance sheets of the major global reinsurers – 24 reinsurers in total. These companies on average hold 24% of their investments in corporate bonds (including 2% in high yield) and 8% in equities.

Figure 10. **Global reinsurers' investment mix, average, excluding NICO**



Source: Company disclosures

Interest rates

The decline in risk-free rates (ie the rally in government bonds; the US 10-year year-to-date rate has gone from 1.9% to 0.7%) is also having a significant impact on the sector's health. But, importantly, the impact is not treated consistently by the rating agencies and local regulators:

- Under Solvency II and Switzerland's Swiss Solvency Test (SST), the liability side of balance sheets is discounted at the current risk-free rate; therefore, when rates fall both the asset and liability side go up in value. Typically, and in particular for life insurers, the liability side changes at a faster pace, as insurers tend to have longer-duration liabilities, hence, a negative impact on capital positions.
- The US risk based capital (RBC) system tends to keep bonds at cost (unless impaired, but this is less likely for a 'risk-free' investment) and tends not to discount liabilities; hence, the move in risk-free rates should have minimal impact on US regulatory capital positions.
- A.M. Best and S&P mark bonds to market. They also discount liabilities but do not move the discount rate in 'real time'; hence, a decline in interest rates may initially show up as a positive for their capital calculations.
- Countries operating under a simple Solvency I regime would likely see falling rates as a positive for capital positions, although stakeholders would likely favour rating agency views over these simple solvency regimes.

The contrasting approaches of these capital regimes could lead to differences in behaviour amongst the global reinsurers. The European reinsurers could be feeling more pressure than other companies not subject to Solvency II or the SST, which could be material. Equity analysts have estimated a negative impact of 15 to 20 percentage points on solvency ratios from falling risk-free rates for several of the European reinsurers.

Credit risk

One issue not considered by the analysis so far is ratings migration. There is widespread anticipation that corporate bonds will start to get downgraded. If a reinsurer finds itself holding a lower-rated bond, its capital charge will go up. A.M. Best, for example, applies a capital charge roughly double on a BB bond versus BBB bond (13% versus roughly 6% for five-to-10-year maturities).

Global reinsurance capital

The global reinsurance sector's corporate bond and equity holdings as a percentage of shareholders' equity is the basis for any calculation relating to the overall impact on a company's solvency. These percentages are estimated to be at 86% for corporate bonds (including 7% for high yield) and 28% for equities, respectively. A corporate bond gearing of 86% suggests that for every 10% move in corporate bond prices, an 8.6% change in shareholders' equity would be expected. Similarly, a 10% move in equities would be expected to deliver a 2.8% change in shareholders' equity. This analysis ignores tax and the possibility that some of these losses will be shared with life policyholders.

Looking at how equity and credit markets have moved year to date (roughly, equities –15% and high-yield credit –10%), these gearings suggest a 5% pretax hit to the global reinsurance capital base. Applied to Willis Re's US$559 billion global reinsurer capital base, that implies capital destruction on the order of US$30 billion.

The good news, however, is that global reinsurers have entered this crisis with strongly capitalised balance sheets. Figure 11 shows the current A.M. Best ratings for the major global reinsurers. At present all enjoy robust ratings, and the picture is similar at S&P.

Figure 12 contrasts A.M. Best's capital adequacy ratio (BCAR) score (99.6 value-at-risk level) of the global reinsurers to how geared their capital bases are to equity and credit. Note that high-yield corporate bonds have been used in this analysis (as opposed to all corporate bonds). The majority of reinsurers remain in the secure top left zone of high BCAR score and lower gearing.

For the Europeans, equity analysts have estimated current solvency ratios. The four major European reinsurers are expected to remain well capitalised with solvency ratios above their self-imposed minimum targets and at the stronger end of the European insurance sector. Having said that, dividend payments have been temporarily suspended by several European (re)insurers.

Similarly, we estimate that the capital position of the US (re)insurance industry remains comfortable. We estimate a 7% hit to statutory capital, and that the aggregate BCAR score will remain well in excess of the level required for A.M. Best's 'strongest' category.

Figure 11. **A.M. Best ratings for major global reinsurers**

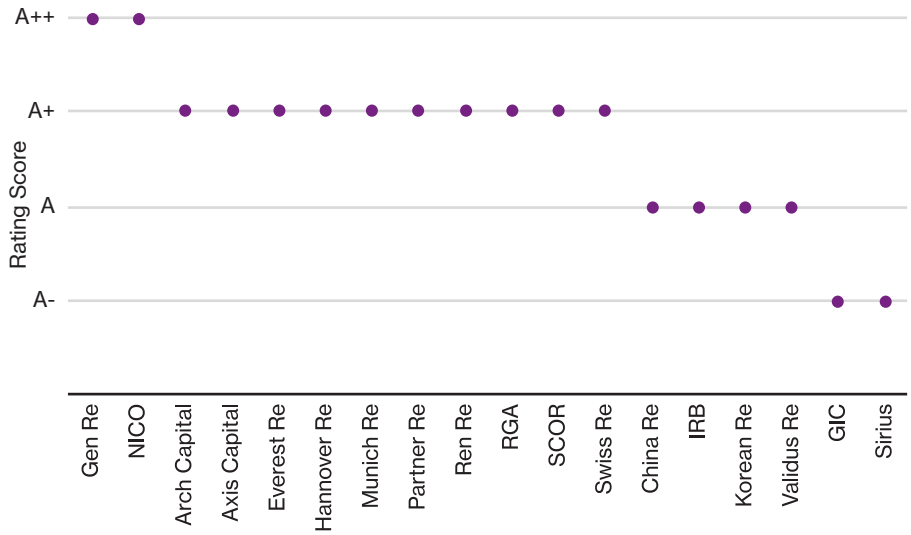
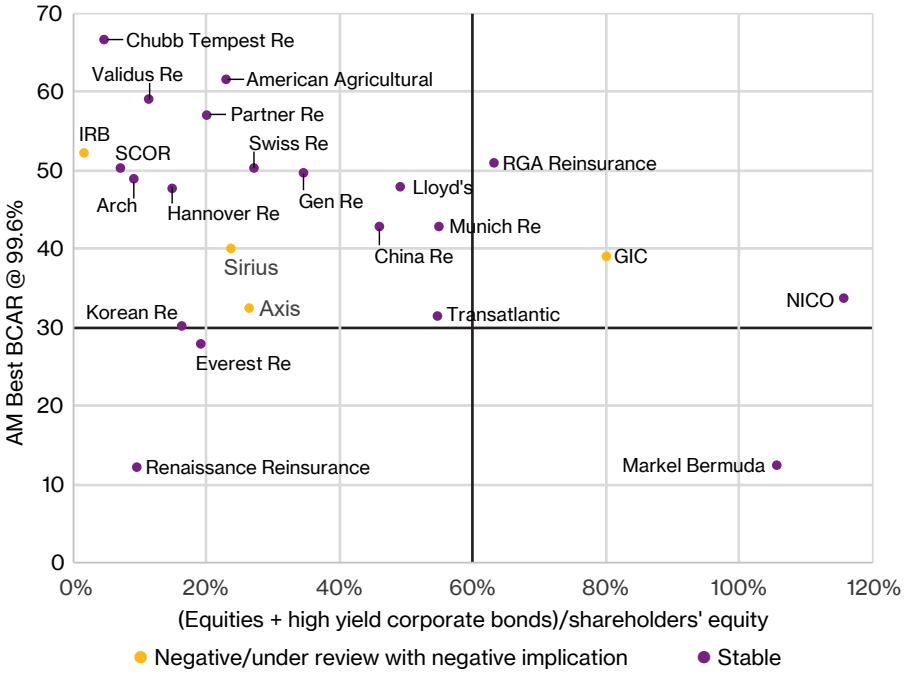


Figure 12. **Global reinsurers' BCAR scores versus capital bases**



The BCAR scores above are for specific reinsurance entities. In some cases, the score may not represent financial strength at the ultimate parent group level. Holding company support would be factored into the final assigned rating. It is important to note that BCAR scores are only one input into AM Best's balance sheet strength assessment, and AM Best's ratings are also determined by other factors in addition to balance sheet strength.

Source: Willis Re and © A.M. Best Europe - Information Services Ltd. – used by permission.

Initial conclusions

The global (re)insurance industry faces a unique set of challenges – unique relative to its history and unique relative to other industries.

Reduced economic activity will almost certainly lead to lower written premium volumes. Businesses that no longer exist or continue to exist on a smaller scale will feed directly into the rateable exposure base part of any premium rating model. Premium refunds are a shock that will impact the current underwriting and calendar years. Slower premium payments by customers in the future will further stretch the premium development pattern.

The typical insurance company's significant gearing to investment market volatility means that capital bases will be meaningfully dented by year-to-date moves. As discussed earlier, this particular balance sheet metric makes it particularly volatile until a clearer picture of the pandemic emerges.

Uncertainty will remain in the industry over COVID-19 claim payments, with litigation potentially prolonging the uncertainty for many years as various legislation makes its way into law and the numerous inevitable appeals from insurance companies are heard in court.

Historically, insurers could usually rely on reserve releases to support the combined operating ratio (COR) reported in accounts and other statutory filings; independent of COVID-19, this support has been reducing over recent years, and in some segments, prior-year development is expected to fall on reduced industry premium pools. COVID-19 claim uncertainty will further pressure reserves. Moreover, if premium income declines, then any pressure from in-force business will have an amplified impact on results going forward owing to a reduced calendar-year premium.

Section 4 explores these concepts in more detail and focuses on:

- Evaluation of capital adequacy
- Adjustment to risk tolerance and appetite
- Evaluation of new underwriting and reserving environment
- Revised objectives for 2020 and beyond

Section 4: Macro insurance industry impact

Introduction

The global life and non-life sectors have been subject to rigorous regulatory oversight and requirements over the past three decades that have incorporated stringent solvency buffers to protect against more remote events to the benefit of policyholders and overall financial market stability. This is especially the case in the more developed economies but also true of emerging economies, some of which are operating with equivalence to established risk-based capital regimes.

Rating agencies now play an influential de facto if not a de jure role in establishing and monitoring their own solvency standards. The sophistication that they adopt has evolved over the same period, adapting to include stochastic modelling methods, including severe and remote stress tests. New stress tests relating to pandemics are being released by all the major rating agencies, likely related to the severity of the ongoing global COVID-19 lockdown. These will surely be integrated and form part of their ongoing monitoring and coverage.

These twin groups have influenced solvency standards that, thus far, appear to have resulted in some compression in industry solvency ratios with excess capital buffers acting as capital shock absorbers, as designed. This has overwhelmingly been driven by volatility in financial markets, some of which as of the time of publication have partially rebounded. What has not yet emerged is the loss cost incurred as a result of COVID-19 nor the reduction in levels of global premium across the Life, non-life commercial and personal lines segments. Uncertainty over possible loss emergence, notably but not exclusively business-interruption-related whether through explicit or implicit granted coverage or legislative edict, will evolve, crystallise and become disclosed over the next several weeks or months. Companies wrestling with external reporting and disclosure will have the added complication of an unprecedented loss scenario. In some instances, the magnitude and disruption caused by COVID-19 might provide a moment of pause in the industry.

Macro-level impact – commercial P&C (re)insurance

The commercial P&C (re)insurance industry has long association with exposure to unpredictable events. It has often adapted to such unforeseen situations by relying upon continuously developing risk management and mitigation techniques rooted in qualitative and quantitative processes. But rarely has the industry been tasked to manage a scenario that challenges the resilience of approach to all areas typically considered in most company's enterprise risk management (ERM) or own risk and solvency assessment (ORSA) framework. COVID-19 will impact every element of the risk spectrum: underwriting risk, reserve risk, operational risk, liquidity risk and asset risk.

COVID-19 has emerged inauspiciously following several years of catastrophe losses coupled with unfavourable attritional loss ratios: the emergence of prior year loss development in some regions in longer tail lines were converging to bring a gradual end to the prosaic soft phase of the insurance cycle. Market conditions were set to improve for insurers; however, insurers now face significant demand contraction, 'live cat' dynamics amid a global pandemic, loss emergence from events thus far and the possibility of weakened balance sheets.

(Re)insurer leaders seeking to recalibrate their polar star will be undertaking their own version of a systematic plan to identify threats, quantify their impact and modify as required.

The commercial P&C industry was seemingly coming to the end of its soft cycle. Catastrophic events occurring over the past few years have impacted the profitability of the property catastrophe line of business, which, in the immediate years prior during a period of benign activity, had subsidised multi-class insurers to an extent that arguably perpetuated the soft-market cycle.

In the casualty arena, the increasing trend in frequency and severity of court awards has been driving up claim costs sufficiently for many to walk away from certain classes of risk. This social inflation effect is well documented in the literature and well covered by various media outlets so will not be discussed extensively in this report.

The effects of more stringent underwriting guidelines imposed by major writers in the speciality and commercial lines insurance space (such as AIG and Lloyd's) were also feeding their way through into market pricing, although these were felt in more localised pockets.

For an industry that has historically enjoyed circa 12% to 15% returns on equity, conditions that delivered mid to high single-digit returns were unlikely to last for too long, notwithstanding the low interest rate environment that has persisted since the financial crisis over a decade ago. Evidence suggests that the market was starting to harden across all classes and most regions anyway. The emergence of COVID-19 is broad enough that it is now more than merely conceivable that it might exacerbate market hardening in the non-life segment, probably weighted more toward the commercial than the personal lines segment – the extent to which for both will depend on how severe the loss burden ends up being.

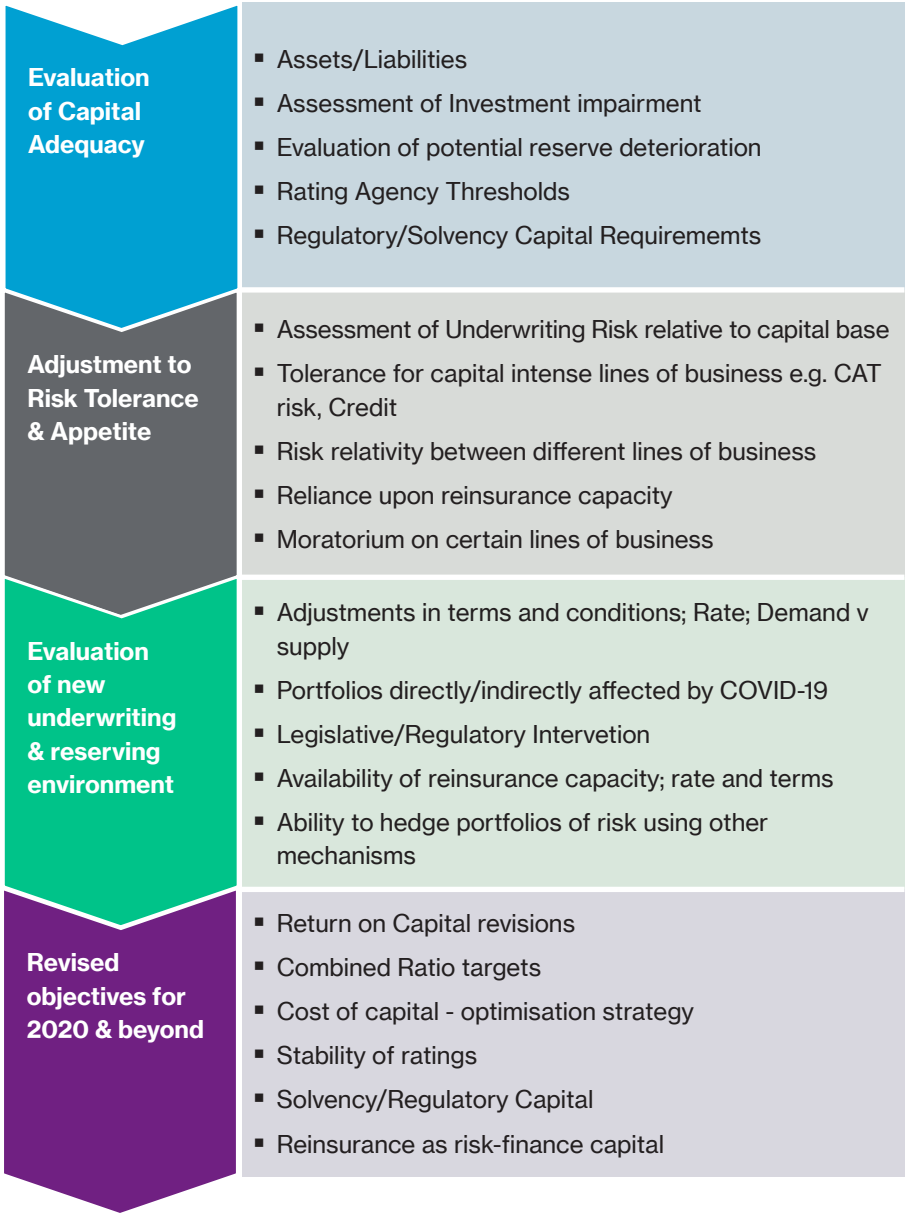
COVID-19 adjustment framework

Underwriting managers should start by assessing the extent to which their portfolios have been impacted directly and indirectly from claims associated with COVID-19. Figure 13 shows a potential framework that (re)insurers in the P&C sector will be evaluating in various guises. The intrinsic link among capital, risk and returns will prevail, but significant actions will need to occur to adapt to a more realistic set of objectives in the near-medium term.

Evaluation of capital adequacy

Given the almost certain requirement for most (re)insurers to reconsider short- and medium-term strategy, the logical starting point would be an evaluation of capital adequacy and longevity in the context of a prolonged period of financial market volatility and threat from material earnings erosion leading to a stress on capital. It is likely that all elements contributing to the bottom line in the near future will come under pressure, be they the loss ratio, expense ratio, investment income or fee income.

Figure 13. **Potential adjustment framework for (re)insurers in the P&C sector**



Lower investment yields, potential for deteriorating underwriting results, possible reduction in premium growth driven by demand or inability of (re)insurers to manage similar levels of risk because of depleted shareholder equity driven by financial market downturn, and the possibility of adverse reserve development, will all drive this pressure on the capital base. The uncertainty over cost and access to capital in all forms will compound the need for judicious evaluation of adjustment to underwriting strategy at the core of every (re)insurance business.

In Europe, the European Insurance and Occupational Pensions Authority (EIOPA) recently declared that this was a significant event,[5] and consequently, insurers need to comment in their upcoming solvency returns on the impact of COVID-19 and any actions they are exploring. Clearly solvency will be impacted by the drop in equities and increase in corporate bond spreads. Moody's has estimated that the European insurance sector's solvency has fallen from 210% at the start of the year to 190%.

[5] https://www.eiopa.europa.eu/content/eiopa-statement-actions-mitigate-impact-coronaviruscovid-19-eu-insurance-sector_en

Rating agencies[6,7] so far have broadly stated that, in aggregate, second-order effects (interest rates, financial market devaluations and general market downturn) are likely to have a more severe impact on the life, health and P&C sectors than first-order effects arising from frequency and severity of COVID-19-related claims. Most rating agencies have stated that the general capitalisation levels of the industry at large are sufficient to withstand the COVID-19 impact.

For some insurers, the decrease in solvency may take them below their desired minimum capital, and they will need to consider what action to take. In addition to regulatory capital, insurers will also need to consider how the rating agency capital models are impacted and ensure they have enough buffer to avoid any unwanted downgrades. For other insurers, the issue may be less around solvency and more around a desire to protect 2020 earnings. They may feel they can manage the earnings impact to date coming from some mixture of:

- Lower premium from decreased business activity
- Expense ratio creeping up as premium decrease exceeds expense reductions
- Some direct COVID-19 claim activity, although this may be offset by reduced claims in motor and other portfolios

However, they may well have a lower risk tolerance for further hits to earnings for the rest of 2020, and we are only a quarter of the way through the year; a lot can still happen. Furthermore, in the past few years, the investment side has been a source of stability to the earnings, offsetting volatility on the liability side, but going forward insurers will have to contend with both volatile investments and liabilities.

Recently some regulators such as EIOPA[5] have communicated their views related to distribution of dividends and their concerns on this matter. For companies experiencing any material capital impairment, there are of course solutions. Figure 14 describes some of the possible routes to addressing the situation of a compromised capital structure. We expect an increase in activity in this field and have allocated additional resources to help (re)insurers that are experiencing or likely to experience capital pressure. There are pros and cons with each customised approach beyond those outlined in Figure 14; speaking to a specialist to assist with the specifics of each individual circumstance is important, and we encourage interested parties to contact their usual Willis Re client advocate or refer to the contact list in Appendix II.

Customised solutions by their very definition are tailored to a specific company's portfolio or needs, and current activity for placements successfully executed by Willis Re on behalf our clients span the full gamut of life and non-life exposures.

Given the current circumstances and not withstanding temporary measures, it is likely that most (re)insurers need to be considering strategies that contemplate operating in the short term on a leaner capital base, which will have a knock-on effect on the three other areas under consideration of the impact framework outlined as follows.

Figure 14. **Possible approaches to addressing a compromised capital structure**

Raise more equity and debt	**Purpose:** Improve solvency
	+ By having ability to adjust the dividend pay-out, insurer has flexibility in the annual financing cost of the equity.
	× Markets volatile/costly. Caps on debt in solvency calculations.
Actively write less business	**Purpose:** Improve solvency
	+ May happen anyway as business activity shrinks (temporarily anyway).
	× Not easy to change business volume that quickly for many insurers. Once lost, hard to win back.
Buy more traditional reinsurance	**Purpose:** Improve solvency, protect earnings
	+ Relatively straightforward to do. Pricing is currently relatively stable.
	× Need to find budget to fund the extra expense for any non-proportional RI
Specific customised RI options	**Purpose:** Improve solvency, protect earnings, provide liquidity
	+ Can be designed to specifically meet goals of insurer
	× Retrospective deals can take a while to execute
Maintain status quo	**Purpose:** Highlight robustness of existing capital/risk policies
	+ Potentially sends positive message in the short term to investors and stakeholders.
	× What if your peers are all taking action...

[5] https://www.eiopa.europa.eu/content/eiopa-statement-actions-mitigate-impact-coronaviruscovid-19-eu-insurance-sector_en
[6] https://www.spglobal.com/ratings/en/research/articles/200415-insurers-dividend-pause-amid-covid-19-concerns-likely-indicates-caution-not-credit-risks-11436532
[7] http://news.ambest.com/PressContent.aspx?altsrc=172&refnum=29148

Adjustment to risk tolerance and appetite

Looking at each in turn, underwriting risk is normally managed through stringent controls of risk tolerance and appetite, defined by risk capacity and aggregate capacity for events; however, these risk metrics are normally a function of available capital and the providers' willingness to accept the return for that risk. Rating agencies suggest that capital erosion in the P&C sector is in the range of 5% to 20% from opening-year positions. Whilst these are material shifts, most in the sector were already well capitalised, so mass negative rating actions are unlikely to occur at this stage.

If the erosion of shareholder equity that has occurred over the past two weeks holds for the balance of the year, it would have the implication that the sector will either knowingly accept more risk by maintaining pre-pandemic risk tolerance and appetite in absolute terms or revise these downward to maintain a proportionality to remaining shareholder equity.

The agility of those operating within the sector and the ability to adapt to a new risk environment will be pivotal to maintaining a sustainable short-medium operating model. Normal risk tolerance and appetite triggers should have been activated in the immediate aftermath of governmental actions, which should result in most companies' governance structures to contemplate changes in risk control framework. This will likely need to address a re-balancing of the portfolio given new capital levels, and a reassessment of underwriting capacity at risk in various sectors of business whether on a risk or event basis. There will be differences of approach between many in the sector that could leave the traditionally well-served client base having to re-evaluate mechanisms to transfer risk.

Of cyclical note will be the property catastrophe sector for US windstorm. Much of this capacity would have been deployed in the early part of 2020, and thus positions have been taken, except for the Floridian carriers that will be contemplating renewal portfolios in June 2020. Key participants in the catastrophe risk sector of the commercial (re) insurance sector will themselves need to assess their ability to maintain portfolios of risk whilst assessing the true cost of capital and required returns. Those that have deployed capacity in the sector may consider hedging strategies using index products and the like.

Evaluation of 'new' underwriting environment

Post-pandemic attitude to responsiveness of (re)insurance products may result in a shift in buying patterns for buyers who opt to retain more risk in its various guises driven by a variety of circumstances, especially where reputational damage to the (re)insured has occurred. If demand for (re)insurance products diminishes, (re)insurers may find a reversion toward similar proportionality to risk versus capital positions as pre-pandemic. Some will not meet the expectation of clients and some will surpass expectations.

The ultimate effect upon profitability will be determined by premium rating conditions, operating costs and cost of capital whether through reinsurance or capital markets. Shifts between underwriting sectors are often more challenging given infrastructural encumbrances, and executives will be careful not to appear to provide an inconsistent or unclear offering to their client base or broking partners.

Terms and conditions

Terms and conditions for (re) insurance policies will adjust to reflect the performance of underlying coverage in sectors that have been affected directly or indirectly (see sections 7 and 8). Short-term tactics to insulate a portfolio from unanticipated claims experience may eventually be replaced by rationalisation of approach once the full impact of COVID-19 has unfolded and can be examined in more detail. To use the reinsurance vernacular, COVID-19 is an active hurricane that has made landfall and there is little interest in unwittingly absorbing more of the same loss. There will inevitably be an adjustment to existing policy coverage and the potential for creation of new cover if demand exists.

Exclusionary considerations

Amongst the range of decisions facing insurance executives will be how to mitigate the immediate continuance of pandemic exposure directly or indirectly. Although the industry has long established the potential threat arising from such exposure, few would have anticipated the extent and speed of the infection and the effects of far-reaching governmental action.

Clauses in existing contracts covering several sectors dealt with the threat through partial or total exclusion (specific or generic), explicit limits, sub-limits or deductible for claims; however, where underwriters have sought to provide bespoke coverage to their clients, there may still be coverage included by the absence of explicit exclusion. Consequently, the impact felt by (re)insurers could be materially different for portfolios in the same class of business.

Our experience so far is that certain reinsurers are using exclusions as a relatively blunt instrument to ring fence themselves from potential COVID-19 losses. Underwriters must therefore be cognisant of the broker's duty to negotiate and seek the best terms available for their clients. Long-term impacts of such exclusionary language and focus on the effects and relevance to the underlying portfolio should also be borne in mind. The likelihood is that broad brush positions will soften, and as clients and reinsurers communicate and discuss the issues, a hierarchy of exposure priorities will emerge, and positions will crystallise based on mutual discussion rather than dogma. The industry has a good track record in resolving these situations, but consensus takes time.

Insurance-linked securities (ILS) markets appear to be taking perhaps the clearest position defaulting to an absolute exclusion stating that their investors will not provide capital on an ongoing basis if an acceptable exclusion is not in place. This approach would be consistent with traditional ultimate net loss retrocession placement where business is transacted on a 'named perils-only' basis rather an 'all-risks' policy form, which is more common in insurance policies, and reinsurance policies for many other lines.

The nature of COVID-19 exclusions

In some instances it is inappropriate to apply a COVID-19 exclusion – for example in EL coverage or on other liability coverage where the risk of disease such as COVID-19 does not represent any increase in risk or is not material to the risks being underwritten, or where they are exactly the kind of risks which should be picked up by such liability cover.

Many of the exclusion clauses in circulation seek to reverse the burden of proof in the imposition of an exclusion, against the interests of the (re)insured. At law, the burden of proof is on (re)insurers to prove that any particular loss falls within the remit of an exclusion in the policy and is therefore not covered. Many COVID-19 exclusion clauses reverse this burden so that the (re)insured is asked to prove that cover should apply if the (re)insurer invokes the COVID-19 exclusion.

Similarly, COVID-19 exclusions often go wider than excluding losses directly as a result of COVID-19 and exclude losses indirectly caused by, or contributed to by, COVID-19.

The timing of the exclusions

Willis Towers Watson is seeing instances where (re)insurers are trying to impose exclusions mid-policy term, sometimes unilaterally, and sometimes in exchange for the agreement of endorsements concerning ordinary matters of policy administration, be they relatively minor or significant. In this, our view is that a client should not be forced to choose between accepting some form of exclusion or not achieving agreement to a wholly unrelated endorsement.

Potential legislative and regulatory intervention

Legislative intervention, in a number of US states, is a feature in the news. The fact that this is an election year in the US could serve to amplify the bravado of politicians, to the detriment of insurance industry participants. We may address the issue of legislative interference in detail in subsequent issues when the position is clear, but the risk of other countries following the lead of the US is an issue. The insurance world watches on with interest, perhaps with the exception of Asia, which has addressed this issue with previous pandemics (for example, Avian Flu, SARS), where there is little ambiguity about coverage issues and the market continues with business as usual.

Regulators have also been vocal about their expectations of insurers, including the Financial Conduct Authority (FCA) in the UK.[8, 9] The FCA expects insurers to be clear about the types of claims that would and would not be covered. Depending on the sector in question, this could potentially put insurers in harm's way if they are eventually forced by legislation to pay claims that are explicitly excluded in the black and white policy wording. This all ignores the potential for reputational damage.

Present

The set of possible outcomes of the challenges in the US, no matter how remote each may seem at the current time, are worth reflecting on for a moment:

- Legislation is passed waiving the requirement for physical damage to have occurred before BI claims can be paid. This is the worst-case scenario for property insurers because almost every industry has suffered severe BI losses; making these insurable would mean that insurers suffer close to BI limit losses across their entire portfolio. This would almost certainly lead to significant impairment arising out of losses not originally covered, priced for or provided for in terms of accumulation management. It is no exaggeration to consider a number of insolvencies, capital impairment industrywide and an immediate hard market.
- Lawmakers and insurers reach a compromise. At this stage, it is unclear what exactly a compromise might look like; however, it has been suggested that the insurance industry could be the mechanism through which a government could distribute cash to businesses that desperately need it.
- New legislation is not enforced. Focusing on the short term, this is the best economic outcome for (re) insurers as it would mean that the status quo is maintained and those with coverage would be able to claim under their policies, and the vast majority who did not purchase coverage for non-damage BI are not able to make any recovery.

The mechanics of this issue are not as straightforward as they may appear, however. In the first scenario, a lengthy legal battle would likely ensue, delaying any payments whatsoever to the businesses the legislation was theoretically changed to save from insolvency. In the third scenario, whilst the insurers would save on paying claims in the short term, the long term absence of a one-time policyholder will have a detrimental impact on future business volumes.

This possibly suggests that the more likely outcome is some form of compromise, in which both sides feel hard done by.

The specific forum for any case to be heard could also be a factor in the likely way forward. Section 5 looks at an example in the UK.

[8] https://www.fca.org.uk/firms/insurance-and-coronavirus-our-expectations
[9] https://www.fca.org.uk/publication/correspondence/dear-ceo-insuring-sme-business-interruption-coronavirus.pdf
[10] https://www.iii.org/article/2019-commentary-on-first-nine-months-financial-results

Future

The current uneasiness of the insurance industry is understandable. On the one hand, various state governments are trying to pass legislation to force insurers to pay BI claims on policies regardless of whether COVID-19 is a covered event. On the other, passing such legislation would shatter the industry, pushing into insolvency the very insurers compelled to pay the COVID-19 claims. The industry's US$800 billion capital buffer,[10] according to the Insurance Information Institute (III), as at the end of Q3 2019 would be burnt through in a matter of days of paying BI losses to US companies alone, so this does not appear to be a viable long-term solution to the current crisis facing business worldwide.

There are two possible ways that the US government could 'backstop' the industry's pandemic exposure. Both proposed solutions appear to have been informed by existing arrangements, so they are known to be administratively feasible.

Pandemic Risk Insurance Act

The first, dubbed the Pandemic Risk Insurance Act (PRIA), is a direct analogue to the existing Terrorism Risk Insurance Act (TRIA, first introduced in 2002), whereby insurers would offer explicit BI coverage for the pandemic peril on original policies and cede a significant portion of this risk to the reinsurance markets. The government would then provide 95% of a US$500 billion layer of coverage in excess of US$250 million in the aggregate, with the residual 5% share maintained by the industry. This would represent a risk-sharing arrangement between the four concerned parties: the policyholder (through the excess or self-insured retention on the original policy), the insurer (through its reinsurance retention), the reinsurer (through the capacity deployed on the reinsurance programme) and ultimately the government, which would theoretically be the payer of last resort.

Structurally speaking, the PRIA proposal is similar in structure to TRIA, but the exposure dynamics underlying each proposal are quite different. Whereas the cost of a terrorist attack can be relatively accurately modelled for a given target, the frequency of such attacks is a great unknown. This makes the structuring of the TRIA programme relatively straightforward since the vertical limit required can be well estimated by existing modelling practices. The converse is likely true for pandemics: the frequency of occurrence could be relatively well understood, but the severity of loss is a very large unknown, making the structuring of any risk-transfer programme more complex.

The lines of business currently contemplated by the PRIA proposals are property, general casualty and workers' compensation only. That would mean that many lines are not covered, including federal crop insurance, private mortgage insurance or title insurance, life or health insurance, commercial auto insurance, burglary and theft insurance, surety and professional liability (also known as errors and omissions [E&O] and directors' and officers' [D&O] insurance).

National Pandemic Insurance Programme

The second possible government backstop would be more akin to the US National Flood Insurance Programme (NFIP). For a peril that was once considered uninsurable, there are now at least two government-backed flood programmes in existence: the NFIP in the US and Flood Re in the UK. In the case of the NFIP, insurers act more as administrators for the government, effectively fronting the flood exposure in the insurance policies sold to homeowners or business, passing 100% of any exposure to the new pandemic-insuring entity. This programme could then be protected by open market reinsurance placements, much in the same way as the NFIP is currently protected.

Few further details were available at the time of writing this report. Future editions will cover any new information available at that time.

Rating environment evolution

Risk-adjusted rate impact will likely occur over all sectors that are directly or indirectly impacted; however, ultimate claims experience may not necessarily be the driving factor for rate change. The second order impact on capital (interest rates, financial market devaluations and general market downturn) hitting capital may drive decisions in terms of allocation between classes of business. This would be especially true if the relative view of capital intensity for individual classes of business has materially changed. On a macro scale, if all participants were to redefine risk appetite and shift capital focus from one sector to another within the P&C marketplace, it is likely that rating environment would exhibit volatility from this act alone.

Loss experience versus capacity
Short- and medium-term reinsurance capacity availability and cost could significantly impact most insurers' prospective underwriting strategies. Across all sectors, reinsurers will be monitoring the extent to which loss-affected classes have materially deviated in loss experience from what they had expected. They will have portfolio-level views of the underwriting performance of different insurers on similar classes of business. Reinsurers will also be feeling the effect of erosion of capital and therefore may seek to rationalise their portfolios to select cedents, classes of business and regions that have fared better than others. Reinsurance providers have the ability to allocate capital between sectors more expediently than their insurance client base and will no doubt exercise this ability in the months ahead as the extent of dislocation is revealed in the post-pandemic world. This may have the effect of driving rate over different sectors for the balance of 2020 and potentially into 2021.

The terms at which that capacity is deployed may also narrow, and the use of 'blanket' exclusionary language in respect of communicable disease may be implemented by some, although reinsurers will also be acutely aware that such practices may leave some insurers unable to offer certain products or with a disproportionate share of risk. Insurers could switch reinsurance panels, use alternative sources of capital to support risk, or perhaps choose an entirely different approach to manage or mitigate risk (eg ILS capacity, collateralised reinsurance).

Tactical reinsurance utilisation
Insurers that wish to secure market share or maintain a broadly similar underwriting strategy as at the start of the year may have to revert to reinsurance solutions to provide temporary or permanent capital relief. Availability and cost of such cover will likely be subject to similar issues that will no doubt be faced by the reinsurers themselves.

Some insurers may seek to augment their depleted capital base via capital markets to sustain market share, but given the volatility of financial markets and the post-pandemic environment, the ability to raise new capital may be limited and cost prohibitive for at least the short term. This may be especially true in an environment where traditional sources of funding may be seeking liquidity themselves or evaluating returns from competing asset classes.

Revised objectives for 2020 and beyond
The unprecedented scale of spontaneous and concurrent global disruption across every industry will have a lasting impact on the development of the global (re) insurance sector. It will require an almost certain reset of objectives for the balance of 2020 and beyond. Political and economic uncertainty has materially increased since the start of the year, which will test the effectiveness and resilience of existing business models.

It remains unclear what an acceptable level of return should or could be; therefore, executive teams will need to focus on the art of the possible. A reconsidered 'bottom-up' approach, which realistically sets a base scenario of maximising returns on the remaining capital whilst insuring its preservation, is paramount for both policyholders and shareholders alike.

After a single quarter, it is entirely possible that some (re)insurers are facing a loss-making year. The industry still faces the annual cyclical natural catastrophe season in many parts of the world, and many carriers will be entering the season with less capital this year than last.

Rating agencies, regulatory authorities and now politicians will be scrutinising the behaviour and strategy of all sector participants with a view of ensuring that the wider economy has suitably transferred risk to the (re) insurance markets and that the market maintains its solvency and claims-paying ability. Recent announcements have suggested that regulators are looking to (re)insurers to suspend share buybacks and dividends to avoid a premature reduction in capital base.

Given the current predicament, (re) insurers may seek to address the following near-term objectives to ensure stability and satisfy regulatory authorities and rating agencies that appropriate steps have been considered.

Figure 15 considers a range of topics to address pressing objectives that will be of interest to the most critical stakeholders: clients, regulatory authorities, rating agencies and shareholders. The most successful strategies will depend on the speed with which executive teams can assimilate the current trading environment, respond with clarity and direction, and articulate to relevant stakeholders an appropriate route forward.

The impact from COVID-19 has far-reaching consequences for reinsurance structuring considerations and placement, particularly in the short term for the remainder of this year and beyond. Challenges to traditional renewal placement will occur, and questions will be asked from both sides of the transaction. Observations from the most recent renewals have been those of dislocation and reflex orientation as insurers have sought to extend coverage while reinsurers and capital markets have tried to mitigate exposure. This was reflective of the overall volatility of financial markets, regulatory response and the accelerating effect of the virus in many countries around the world.

However, now that the significant 1 April treaty renewal date has passed, there is a moment of pause. It will allow for the critical questions to be asked and answered and provides time for insurers and reinsurers to understand their own positions in respect of the circumstances outlined in the sections above.

During the next few months, Willis Re will be seeking to translate an understanding between clients and markets that reflects an equitable way forward to allow for the smooth operation of our marketplace, globally and regionally. To do that, Willis Re will seek to assist our clients and markets to prepare for pre-renewal discussions in a comprehensive but noninvasive fashion to allow for the orderly consideration of post-pandemic conditions.

Figure 15. **Objectives and strategies for insurance stakeholders**

Evaluation of Capital Adequacy

- Protection and preservation of existing capital (short- and medium-term measures)
- Consideration to access further capital commitments from financial markets
- Maintenance of solvency margins and rating agency "buffer" capital – or a plan to reload margins over an appropriate timeframe
- Demonstrate ability to meet obligations to policyholders (liquidity)

Adjustment to Risk Tolerance & Appetite

- Quantification of exposure to COVID-19 from portfolios, either directly or indirectly
- Articulate strategy to minimise future unintended exposure or specific application of controls to define absolute limits
- Define adjustments to risk tolerance and appetite reflecting capital levels, rating agency concerns, and regulatory solvency requirements
- Demonstrate resilience of capital base and articulate plans to access new capital if required

Evaluation of new underwriting & reserving environment

- Evaluate post-pandemic underwritiing environment, client needs for capacity and cover
- Identify capital intensive LOBs and link to hedging strategy (i.e. reinsurance, retro, sidecar)
- Define near-term actions to mitigate potential for further capital erosion from known exposures to capital intensive business (e.g. natural catastrophe risks)
- Define near-term profile of assumed portfolio of risk and manage growth for the remainder of 2020

Revised objectives for 2020 & beyond

- Define and articulate to relevant stakeholders new targeted perfomance metrics in light of rapid shift in economic and industry conditions
- Shift part of management attention to short-term tactical decisions to address the immediate concerns of primary stakeholders (Policyholders, Regulators, Rating Agencies, Shareholders)
- Reassess external risk-finance and reinsurance cycle management strategy in the context of potential supply/demand imbalance

Willis Re continues to advocate the advice of measure, manage and mitigate exposure to COVID-19; however, this will need to be demonstrated through modelling and metrics on a more granular level to ensure the appropriate protection is being considered, and to provide comfort to the reinsurance market that quantum of exposure is defined. Further, post-pandemic underwriting actions that will alter the shape and nature of portfolios of risk will need to be articulated to the market, outlining the potential impact on exposure and highlighting the effectiveness of prior underwriting discipline. We will also partner with clients that are likely to need a more creative approach to establish solutions on a bespoke basis that manages a possible transitionary exposure period pre- and post-pandemic.

Cedents should consider their portfolios and potentially consider the questions in Figure 16, particularly in respect of property sector exposures. Notwithstanding that these questions are specific to the property line of business, they can be useful for other lines as well. The responses to these questions could play a significant role in any upcoming renewal and act as a useful discussion aid in easing their concerns, hopefully leading to a better outcome for all concerned parties.

Willis Re is working with reinsurance markets to ascertain their views of acceptable risk to the newly recognised severity of pandemic exposure and whether this is manageable through binary exclusionary methods alone or whether this will be seen in the fullness of time as a blunt instrument. The reinsurance community that has emphasised the value of strategic relationships and continuity of cover will likely be tested by some of their most valued and respected clients. Clients will eventually distinguish between short-term opportunism and long-term strategic partnerships of value.

Figure 16. **Questions to consider concerning property sector exposures**

Covid-19 impact on property portfolio	Business linterruption as a result of communicable or infectious disease?	Business interruption as a result of any other special perils?	Pandemic?	Denial of access or non-damage loss?	Performance disruption?	Contingent business interruption?	Any other specific exposure potentially exposed to COVID-19 related claims?
How many policies have you written extending such coverage?							
Is your coverage sub-limited or offered at full limits? What are typical (sub)limits and deductibles?							
In what territories have you written such policies?							
What do you estimate is your total exposure under these policies?							
For such coverage to be triggered, do your policies require:							
there to be “physical loss or damage”?							
disease to be actually present at the location or within set radius of location?							
governmental action to be taken?							
any other trigger?							
May we have a copy of your relevant policy wording(s)?							

Initial conclusions

This section would not be complete without some general guidance notes for companies with a reinsurance placement incepting over the course of the next few quarters. Our recommendations are summarised below, but in the event of any questions, please reach out to your Willis Re representative.

- **Accelerate the reinsurance calendar.** If possible, advance the placement cycle by one month; specifically accelerate data capture, the modelling and analysis phase, and the compilation of reinsurance submission and its distribution to reinsurers each by four weeks. This will cater for operational delays in the working from home environment that prevails and ensure adequate time to address any emerging market externalities.
- **Engage early.** The point of the accelerated time frame is not only to compensate for delays in operational aspects but also to ensure that the engagement, presentation, price discovery and placement phases are all accelerated.
- **Adapt but don't abandon communication strategy.** Replace any customary market meetings with your global panel of reinsurers with virtual meetings; conveying the necessary message is even more important in prevailing market conditions and where reinsurers are likely to continue to differentiate by clients.
- **Prepare to debate COVID-19.** Clients cannot overprepare for reinsurer discussion on COVID-19, so come to these virtual meetings prepared to articulate views (by class) on perceived exposure, relevant loss activity, underwriting strategy by risk segment type of class as well as coverage, if any, and the impact on pricing. Many reinsurers will be interested in levels of premium, but more will be interested in rate adequacy, so shed light on any analysis that demonstrates exposure-adjusted rate movement that considers entire segments of the developed world lying fallow in terms of commercial/economic output with concomitant reduction in exposure.
- **Prepare to debate exclusions.** Some classes will require COVID-19 and/or pandemic exclusions, with the determination of on what basis evolving over time; however, buyers should approach discussions well prepared. From a treaty perspective, it is realistic to know that some classes will require COVID-19 and/or pandemic exclusions with reinsurers mostly aligned on this change. Buyers should consequently approach discussions well prepared around the exclusions being implemented on original business to ensure that treaty reinsurance best matches this.

Section 5: Micro insurance industry impact

All (re)insurers have implemented their respective business continuity practices, which from a day-to-day perspective include working from home and adapting to practices for binding new contracts, where possible. Most have been able to leverage existing technology and infrastructure to allow their workforce to operate remotely.

So far, discussion has focussed on holistic impacts to the industry. The nature of the (re)insurance industry is such that different segments will be impacted to varying degree, be they life, health or P&C. Sections 7 and 8 will consider each in more detail, but some high-level commentary on global issues affecting some of the subclasses can be found in this section.

Extensions, extended premium payment terms, midterm adjustments and notices of cancellation for non-payment are being considered on a case-by-case basis for those with extenuating circumstances. Insurers are expected to comply with local directives, where they exist. To date, insurers are honouring open quotes, and we have seen no instances of Material Adverse Change clauses being invoked.

The slowdown in the wider economy has caused rapid declines in the rateable exposure base (eg BI values, cargo, payrolls). This is becoming an immediate issue for renewals and a very real consideration for in-force programs where there may be minimum premiums applicable.

Many lines of business will be impacted, both directly and indirectly, including but not limited to those in Figure 17.

Figure 17. **Lines of business contemplated in this report**

Aerospace	Life
Credit and Surety	Marine
Cyber	Mortgage
Engineering and Construction	Property, including business interruption (BI)
Financial lines	Retrocession
General casualty, including general liability (GL), employers liability (EL) and environmental impairment liability (EIL)	Specialty casualty
Group life and Disability	Specialty short-tail
Health	Surety
Health care (including malpractice)	Upstream energy
ILS	Workers' compensation

Willis Re is being approached by clients concerned about the impact on them and the business lines in which they participate. In response, we have mobilised our specialists across the globe and solicited their feedback to a specific set of questions to address some of our client concerns. Feedback from our specialists can be found in Sections 6, 7 and 8 of this report and is broken down in line with the three operating units of Willis Re: North America, Global Specialties and International.

Line of business impacts

Figure 18 is a useful template that (re) insurers can use to create their own hierarchy of priorities in which the relative riskiness of their portfolio can be assessed. It establishes for each sector a relative likelihood of being impacted by claims from COVID-19 directly or indirectly, estimating loss propensity within the sector (column 1), its impact on the sector (2) and its impact on the industry at large (3).

As always, this exhibit is designed to be informative, not conclusive. We would encourage seeking formal advice from your Willis Re representative.

Sectors at the top of the figure are more likely to impact the industry at large than those lower down, which, whilst likely to be loss making in isolation, should have a lesser impact on the Industry, given their relative size.

One critical aspect in understanding the possible impact of COVID-19 loss is the sheer amount of limit that the insurance industry makes available insuring physical assets. A small percentage with explicit non-physical and/or pandemic coverage can amount to tens of billions of limits exposed. There is no exaggeration that despite a small take-up ratio of specific coverage, such losses could potentially amount to one of the largest ever insured losses. The potential for legislative changes that render clear and unambiguous exclusions void has the potential to expose limits that exceed the financial resources of the entire industry.

Figure 18. **Hierarchy of priorities to assess relative portfolio risk**

Sector	Propensity of Loss (1)	Exposure to Sector (2)	Exposure to Industry (3)
Property (inc. BI/CBI)			
GL/EL/PL			
Marine			
Workers Comp			
Contingency			
PA and Travel			
Trade Credit and Political Risk			
Cyber			
Healthcare (inc. Med Mal)			
Surety			
Energy			
MPL			
Auto / Motor			
Aviation			

Severity level: 1 2 3 4

Detailed feedback in the latter sections will help (re)insurers asses the current view on exposure, coverage and impact of COVID-19, thereby allowing companies to:

1. Diagnose where COVID-19 claims could penetrate a portfolio and establish a hierarchy of the more or less exposed classes of business
2. Quantify the specific impact from COVID-19 loss activity
3. Formalise prospective underwriting strategy to deal with COVID-19
4. Anticipate the impact on current business plans, including premium levels, loss and expense ratios as well as reinsurance negotiations

Threat and impact analysis from insured loss will parameterise a broader, enterprise-wide review of the business that will combine all sources of risk with all sources of risk finance capacity and the associated volatility.

Would insurance policies cover losses related to COVID-19?

Losses related to COVID-19 could be covered under different insurance policies, but circumstances and policy language are paramount.

As health authorities work to contain the spreading of COVID-19 and organisations bolster resilience plans, questions often arise about whether certain insurance policies would cover COVID-19 losses. The short answer is, It depends.

Generally speaking, many factors affect whether a loss would be covered under an insurance policy, including the type of loss, the type of coverage, and the terms and conditions of specific policies. Here we review how losses might be treated under a few lines of coverage.

US workers compensation: Losses must arise from the course of employment

Traditionally, to be covered under a workers' compensation insurance policy, it must be determined that the loss to the employee rose out of the course of employment, which may be difficult to establish in the event of a virus outbreak. Employees traveling on business into infected areas or those stationed permanently or semi-permanently in high-risk areas would be the most likely to make convincing cases.

Companies may find themselves in a situation where some employees can work from home but others are needed in the office. If quarantining becomes commonplace, do employees still commuting to work fall into the category of workers traveling into infected areas? Medical and lost-time claims arising from employees going to work in such conditions may more likely be compensatable under a workers' compensation program.

US employers should consult state workers compensation laws. While these laws do not address COVID-19 per se, they often address the question of benefits afforded employees infected or injured while overseas. In the event of an outbreak within the US, it will be important to document immediately with the carrier any potential exposure or infection of an employee.

Employers may also want to consider an individual voluntary workers compensation policy specifically addressing such events as a flu outbreak. In terms of the financial impact of a pandemic, companies should also consider that their share of the expense for medical coverage for employees will rise with the need for medical treatment.

For many US-based organisations, elements of their businesses extend outside of the US. That may entail having US staff travel or work temporarily abroad, while others may have established business entities with full-time employees who may also travel and work abroad. Those scenarios introduce additional considerations when it comes to ensuring adequate protection from illnesses such as COVID-19.

For example, state laws governing workers compensation coverage limit how a policy can apply coverage to employees outside the US. Additionally, coverage for work-related illness or injury for employees based outside the US is largely a government-managed social security program with country-specific regulation. Global organisations should consider separate foreign voluntary workers compensation policies offering state-of-hire or country-of-hire benefits to address gaps in coverage that can develop as well as offer specific coverage for regional or endemic diseases.

Property: Is there a physical loss?

Generally, property policies cover physical loss or damage to insured property resulting from a covered peril (all risks). Without physical damage from a covered peril, income loss associated with people choosing not to travel and/or people choosing not to patronize a business (even if travel is restricted by a government authority) has generally, at least historically, not triggered property insurance coverage.

That said, some property policies include sub-limited coverage for income loss associated with disease, murder and suicide, which occurs at (or sometimes in the vicinity of) an insured location. These policies are often issued to soft occupancies, including (but not always limited to) hospitality, retail and entertainment.

Other occupancies' policies may also have similar sub-limited coverage. In addition, some of these sub-limited policies require as a condition of coverage that a governmental authority enforce a shutdown or limit access to the insured's business.

The general intent of this sub-limited cover is to afford BI coverage if, for example, an outbreak of a disease and/or a murder at an insured location results in people choosing not to patronize a business. Previously, as in the case of SARS, bird flu and Zika, coverage for these situations was provided at times, but such coverage was determined by specific policy wording.

As for contingent BI, coverage requires covered direct physical damage to property of a customer or supplier. The COVID-19 virus would not ordinarily constitute physical damage to property, so the insured's financial loss resulting from the inability to supply a customer, or a supplier being able to supply the insured due to the effects of COVID-19, would generally not be covered, notwithstanding the potential state-specific interventions in the US.

General liability: Causation could be a major hurdle for plaintiffs

Manufacturers of antiviral drugs may face product liability litigation, and entities that interact with the public (eg hospitals, schools, restaurants, airlines, cruise lines, supermarkets) may see litigation if customers believe they can link their illnesses with staff illnesses.

Workers compensation statutes may not shield employers from suits by their contract employees and will not shield them from suits brought by their customers. As it has in the past, proof of causation will be a major hurdle for these plaintiffs. Entities with clear and enforced pandemic policies (eg policies that seek to limit transmissions and keep sick workers home) will have additional defences.

Casualty coverage for US-based organisations is available in two separate markets based in the US and international coverage territories. For organisations with exposures outside the US, similar considerations should be reflected in how coverage is arranged for both the US general liability and international general liability policies, including both coverage and structure.

Supply chain issues and trade disruption insurance

Supply chain management is essentially about dependency – and with dependency comes vulnerability. A global disruption from a flu pandemic might affect the entire web of supply interdependencies: suppliers, their suppliers and their suppliers in turn.

Companies that limit supply chain exposure by broadening their range of suppliers will be less affected but not be immune to the impact of a large-scale supply chain disruption. Companies that have taken an opposite strategy and reduce the number of suppliers, even to a single source, are especially vulnerable. The potential for uninsured consequential loss of revenues caused by delays in the trade flow disrupted by a pandemic is enormous.

Loss or extra expense might be triggered by:

- Emergency partial or total closure of ports and transportation centres due to order of a local or federal government
- Quarantine
- Confiscation or seizure of a product in transit
- Embargo of potential contaminate

Trade disruption insurance (TDI) focuses on the consequential loss potential as a result of loss of earnings, extra expenses and contractual penalties incurred as a result of delays or disruptions in trade flows growing out of the events listed above. TDI differs from the standard BI coverage afforded by marine cargo or property forms by not requiring that there be a direct physical loss to goods or their conveyances. Such policies could provide some level of protection to companies with complex global supply chain interdependencies.

The insurance cycle and the pandemic cycle

The longer the period of outbreak, the more likely a pandemic would be active during an insurance buyer's renewal time. It is important for buyers to position their own risk strategically with underwriters and be aware of changing market conditions or exclusions that arise as a result of the any outbreak.

While insurance is designed to be as comprehensive as the market will bear, there are limitations of risk transfer through insurance, and this makes risk mitigation critical. Risk managers should stay aware of the global situation, monitor health advisories from world health organisations and, most important, maintain a dynamic business continuity model that addresses the concerns and wellbeing of the organisation's employees as well its physical and financial assets. These are powerful weapons against potentially catastrophic consequences.

Issues such as COVID-19 and other events emanating from external environments should encourage a thorough risk review at an enterprise level to evaluate the impact to an organisation's employees, physical assets, brand and balance sheet. Factors that will play a role will include an organisation's industry, the geography(ies) in which they operate, the business philosophies around risk mitigation, and pricing and coverage available from each respective insurance market.

BI in the UK market[11]

The limitation of BI coverage within property policies in the UK is proving to be a key area of discussion. The specific circumstances considered at the time of insurance purchasing are rarely contemplated when rare events such as hurricanes or pandemics occur. Pandemics, in particular, were unlikely to have been a focal point at a given insured's last renewal, which is what makes the BI coverage more prominent now.

Policyholders, particularly those that are commercial in nature, rely on their broker to assist in arranging bespoke insurance policies that are designed to cover the risks the business faces in its daily operation, and the doctrine of frustration from a legal perspective is not always at the top of the agenda for either party, nor the insurer's. That is to say that the parties to the contract are not presented with an opportunity pre-occurrence of a loss to be released from the obligations to the contract due to underlying situations that the contract did not contemplate. Insurance is very effective at dividing the cost of claims arising out of future events but only once the event has happened.

Standard insurance policies in the UK divide policyholders into three categories when it comes to the extent of BI coverage contained in their policies (Figure 19).

Figure 19. **Three categories of policyholders related to BI coverage**

Category A	Category B	Category C
▪ Limited to consequences of property damage ▪ Extended cover can be purhcased for "notifiable disease, vermin, defective sanitary arrangement, murder and suicide"	▪ As Categroy A, plus: ▪ Consequences of "notifiable disease" ▪ For hotels, restaurants and pubs, cover would extend to... within a radius of 25 miles	▪ Insurance only for named diseases e.g. H1N1 "swine flu" and the original SARS coronavirus (SARS-CoV) ▪ For example, H1N1 "swine flu" and/or the original SARS coronavirus (SARS-CoV)

It would be understandable, save for legislative intervention, that:

- Category A insureds would not be able to claim for an outbreak affecting their business since no associated property damage occurred.
- Category B insureds should be able to claim under the policies and be entitled to full indemnification, subject to other terms and conditions (eg policy limits).
- Category C insureds would likely be in a grey area: COVID-19 is not specifically named on the policy, but it is a strain of coronavirus, others of which are explicitly named.

Insureds that find themselves in Category C might have historically had to argue in court that their policy should pay, with no certainty of outcome aside from the legal bill payable. In April 2019, however, the UK's Financial Ombudsman Service, which is designed to protect the interests of consumers, had the extent of its jurisdiction increased to include companies with annual turnover of less than £6.5 million (US$8.04 million) and either a balance sheet of less than £5 million (US$6.18 million) or employing fewer than 50 people. This increased remit could feasibly include many more companies than before, particularly small and midsize enterprises (SMEs), who may be the most exposed to going out of business should they have coverage issues relating to their BI insurance.

Therefore, insurers should be mindful of how a possible claim circumstance might be received by the ombudsman, rather than a court of law, given the proximity of COVID-19 to some of the named diseases contained in the policies of Category C insureds.

[11] James Davey British Insurance Law Association - Coronavirus - insurance, frustration and frustrated customers

Property accumulation

The issue of regulatory or legislative interference in the payment of BI claims made under property policies is well covered in other sections of this report; however, there are some instances of individual companies explicitly offering non-damage BI limit as standard on all policies issued. There is usually a significant sub-limit for such exposures, but these can still accumulate to substantial insured values if there are many policies in the portfolio, leading to a perhaps unanticipated accumulation.

The possible knock-on effect to reinsurance coverage is equally substantial. Reinsurance contract wordings in the property treaty market usually contain similar language to the reinsured's original policies, particularly regarding specific definitions and coverages. This means that any accumulation of underlying exposures from, say, non-damage BI directly expose reinsurers to losses occurring. Occasional qualifying conditions may apply; for example, the loss must be caused by a government-mandated shutdown of operations, which, in the case of COVID-19, makes all claims valid.

Companies that offer cover for non-damage BI in the direct and facultative (D&F) market have greater control over their exposure since they should (in theory at least) be underwriting each and every risk individually. On the other hand, an insurer that has set up a facility or an arrangement to insure professional affiliation groups (or more generally, affinity groups) will have less control since there is usually a sales representative responsible for distribution, a process that carries an inherent lag. Should the insurer, subsequent to the initial offering, find a problem with its policy wording – for example, covering non-damage BI losses caused by government restrictions – a moratorium would take longer to effect than in the case of the D&F insurer.

Marine industry accumulations[12]

COVID-19 has impacted vessel behaviour resulting in a different risk and aggregation profile compared with that of 2019. The main affected sub-sectors of the marine industry are container ships and the cruise industry.

Container ships

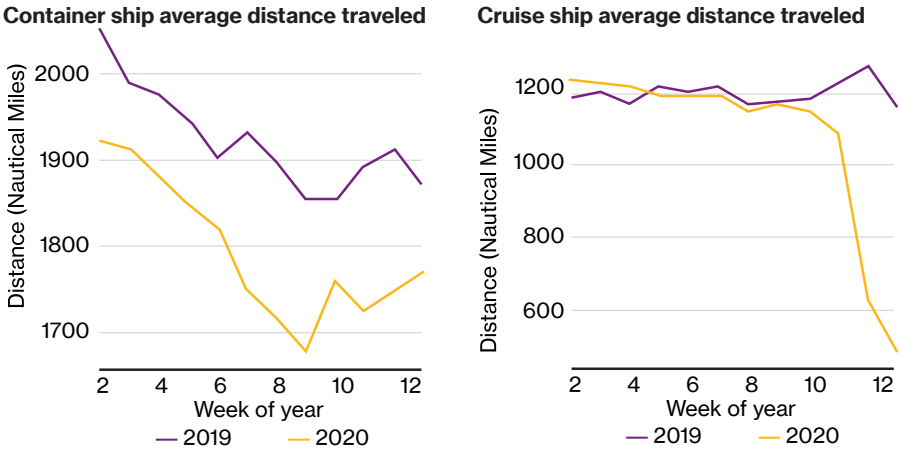
The average weekly distance travelled by large container ships significantly declined in February, dropping from 1,900 to 1,720 nautical miles compared with the same time in 2019. The average weekly distance travelled across the sector is starting to increase, and as traffic increases, ports are likely to be met with increases in cargo throughput, which could in turn result in an accumulation of risk at key ports around the world.

Some major container lines operating between Europe and Asia are choosing to avoid using the Suez Canal as it is now more commercially viable to sail around the Cape of Good Hope, burning more fuel but avoiding the hefty tolls for using the canal. The new route also exposes both the vessels and their cargo to more onerous weather conditions in the South Atlantic, Southern and Indian Oceans rather than the usual calmer waters of the Mediterranean.

Cruise industry

The cruise industry has been one of the hardest hit sectors as a result of the global pandemic. The graph opposite shows that by the middle of March average weekly distance sailed by cruise vessels had dropped by almost 60%. From an insurance perspective this means that high-risk aggregation is likely with a lot of these vessels using the same ports to shelter.

Figure 20. **Average ship distance traveled**



Initial conclusions

The emerging market consensus is that property BI is the key concern for (re) insurers. The potential for loss, even in the absence of legislative interjection on coverage, is significant given the quantum of limit traded in this market.

The initial market feedback regarding the classes of business impacted most directly (cancellation/contingency, trade credit, travel) is proving to be a more minor concern at this time given their size relative to property and other more significant classes. The feedback that follows, gathered from our specialists, will dive deeper into each area to give more insight into particular nuances applicable in each case.

[12] In conjunction with Concirrus, Powering the future of insurance, https://www.concirrus.com/

Section 6: Questionnaires

Survey questions

We asked our specialists to comment on each of the three questions below with targeted subsections, specifically in relation to their sector.

1. Cedents that operate in your sector in respect of their original business:
   a. Current insurance risk appetite/ tolerance vs. the beginning of 2020?
   b. Impact on their business plans and new business development?
   c. Immediate prognosis of insurance claims environment (claims arising directly vs. indirectly from pandemic event)?
   d. Impact on insurance renewal pricing and structure of coverage (deductibles, limits, reinstatements, and so on)?
   e. Scope of insurance coverage and exclusions?
2. Cedents that operate in your sector in respect of their ceded business:
   a. Effectiveness of reinsurance structures (net risk retention, limits, recovery prospects)?
   b. Appetite of reinsurance purchasing post-pandemic (more vs. less cover required; increased retention vs. affordability)?
   c. Credit worthiness of reinsurance providers (adjustments in credit committee criteria, changes to counterparty accumulation tolerances)?
   d. View of availability of capacity and rating environment in reinsurance markets?
   e. View of reinsurance scope of cover?
3. Markets (reinsurance or retro) that provide capacity in your sector:
   a. View of exposure directly or indirectly to COVID-19-related claims?
   b. Likely impact to coverage terms and conditions provided?
   c. Sustainability and longevity of existing reinsurance products and solutions?
   d. Potential impact on rating of existing products?
   e. Risk appetite and tolerance of writing classes of business with potential exposure (or relative attractiveness if indirectly related)?
   f. Impact upon risk appetite on non-directly exposed lines of business (eg property catastrophe)?
   g. Potential impact from capital/ balance sheet factors on capacity (reduction in shareholder equity, reduction in investment returns, reliance on collateral, reliance on funds)?

Our aim is to be updating this view as new information surfaces. We will do so periodically, as appropriate.

Survey responses

1. How would you rank the level of concern amongst the clients (buyers) that operate in your sector in respect of their original business?

LOB	Geography	a. Current insurance risk appetite/ tolerance vs. the beginning of 2020?	b. Impact on their business plans and new business development?	c. Immediate prognosis of insurance claims environment (claims arising directly vs. indirectly from pandemic event)?	d. Impact on insurance renewal pricing and structure of coverage (deductibles, limits, reinstatements, and so on)?	e. Scope of insurance coverage and exclusions?
Healthcare	North America	Med	Med	Low	Med	Low
Property	North America	Med	Med	High	Med	High
Casualty	North America	Low	Low	Low	Low	Low
Workers' Comp	North America	Med	High	Med	Med	Low
Financial Lines	North America	Low	Low	Low	Low	Low
Mortgage	North America	Med	Med	Low	High	Low
Surety	North America	Med	High	Med	Low	Low
Group Life and Disability	North America	High	High	Med	Low	Low
Individual Life	North America	High	High	Med	N/A	High
Retrocession	Global Specialties	Med	Med	High	High	High
ILS	Global Specialties	Med	Low	Low	Low	Low
Aerospace	Global Specialties	Low	Med	Low	Low	Low
Specialty Casualty	Global Specialties	Med	Med	Med	Med	Med
Marine	Global Specialties	Med	Med	Low	Low	Med
Upstream	Global Specialties	Low	Med	Low	Low	Med
Specialty Short-tail	Global Specialties	Med	Med	High	High	High
Engineering & Construction	Global Specialties	Low	Med	Low	Low	Low
Cyber	Global Specialties	Med	High	Low	Low	Low
Property	International (EMEA)	Med	Med	Low	Med	Med
Property	International (APAC)	Med	Med	Low	Med	Low
Credit and Surety	International	High	High	High	High	Med
Casualty	International	Med	Med	Med	Low	Low
Property	International (LATAM)	High	High	High	High	High
Life	International	Low	Low	Low	Med	Low

2. How would you rank the level of concern amongst the clients (buyers reinsurance or retrocession protection) that operate in your sector in respect of their ceded business?

LOB	Geography	a. Effectiveness of reinsurance structures (net risk retention, limits, recovery prospects)?	b. Appetite of reinsurance purchasing post-pandemic (more vs. less cover required; increased retention vs. affordability)?	c. Credit worthiness of reinsurance providers (adjustments in credit committee criteria, changes to counterparty accumulation tolerances)?	d. View of availability of capacity and rating environment in reinsurance markets?	e. View of reinsurance scope of cover?
Healthcare	North America	Low	Med	Low	Med	Med
Property	North America	High	High	Med	Med	High
Casualty	North America	Low	Low	Low	Low	Low
Workers' Comp	North America	Low	Low	Med	High	Med
Financial Lines	North America	Low	Low	Low	Low	Low
Mortgage	North America	Low	Low	Low	Med	Low
Surety	North America	Low	Low	Low	Low	Low
Group Life and Disability	North America	Low	High	Low	High	Med
Individual Life	North America	Low	High	Med	High	Med
Retrocession	Global Specialties	High	Med	Med	High	High
ILS	Global Specialties	Low	Med	Low	Med	Med
Aerospace	Global Specialties	Low	Low	Low	Low	Low
Specialty Casualty	Global Specialties	Med	Med	Med	Med	Med
Marine	Global Specialties	Med	Med	Med	Med	Low
Upstream	Global Specialties	Med	Med	Med	Med	Low
Specialty Short-tail	Global Specialties	High	Med	Med	High	Med
Engineering & Construction	Global Specialties	Low	Low	Med	Low	Med
Cyber	Global Specialties	Med	Med	Med	Med	Low
Property	International (EMEA)	Med	High	Low	Low	Med
Property	International (APAC)	Low	Med	Low	Med	Med
Credit and Surety	International	Med	Low	Low	Med	Med
Casualty	International	Med	Low	Med	Med	Low
Property	International (LATAM)	High	Med	Low	Low	High
Life	International	Low	Low	Low	Med	Low

3. How would you rank the level of concern amongst the markets (reinsurance or retro) that provide capacity in your sector in respect of your assigned sector?

LOB	Geography	a. View of exposure directly or indirectly to COVID-19-related claims?	b. Likely impact to coverage terms and conditions provided?	c. Sustainability and longevity of existing reinsurance products and solutions?	d.Potential impact on rating of existing products?
Healthcare	North America	Med	Med	Med	Med
Property	North America	High	High	Med	High
Casualty	North America	Med	Med	Low	Low
Workers' Comp	North America	Med	Med	High	High
Financial Lines	North America	Low	Low	Low	Low
Mortgage	North America	Med	Low	Low	Med
Surety	North America	High	Low	Low	Low
Group Life and Disability	North America	Med	Low	Low	Med
Individual Life	North America	Med	Low	Low	Med
Retrocession	Global Specialties	High	Med	Med	High
ILS	Global Specialties	Low	Low	Low	Low
Aerospace	Global Specialties	Low	Low	Low	Low
Specialty Casualty	Global Specialties	Med	Med	Med	Med
Marine	Global Specialties	Low	Low	Low	Low
Upstream	Global Specialties	Low	Low	Low	Med
Specialty Short-tail	Global Specialties	High	High	Med	High
Engineering & Construction	Global Specialties	Med	Low	Low	Low
Cyber	Global Specialties	Low	Med	Med	Med
Property	International (EMEA)	Low	Med	High	Low
Property	International (APAC)	Low	Low	Med	Med
Property	International (LATAM)	Med	Med	Low	High
Credit and Surety	International	High	Med	Low	Low
Casualty	International	Med	High	Low	Med
Life	International	Low	Low	Low	Med

3. How would you rank the level of concern amongst the markets (reinsurance or retro) that provide capacity in your sector in respect of your assigned sector? (continued)

LOB	Geography	e. Risk appetite and tolerance of writing classes of business with potential exposure (or relative attractiveness if indirectly related)?	f. Impact upon risk appetite on non-directly exposed lines of business (eg property catastrophe)?	g. Potential impact from capital/balance sheet factors on capacity (reduction in shareholder equity, reduction in investment returns, reliance on collateral, reliance on funds)?
Healthcare	North America	Med	Low	Low
Property	North America	Med	High	Med
Casualty	North America	Low	Low	Low
Workers' Comp	North America	High	Low	High
Financial Lines	North America	Low	Low	Low
Mortgage	North America	Med	N/A	Med
Surety	North America	Med	N/A	Med
Group Life and Disability	North America	High	Med	High
Individual Life	North America	High	Med	High
Retrocession	Global Specialties	High	High	High
ILS	Global Specialties	Low	Med	Med
Aerospace	Global Specialties	Low	Low	Low
Specialty Casualty	Global Specialties	Med	Med	Med
Marine	Global Specialties	Low	Low	Med
Upstream	Global Specialties	Med	Low	Med
Specialty Short-tail	Global Specialties	High	High	High
Engineering & Construction	Global Specialties	Low	Low	Low
Cyber	Global Specialties	Low	Low	Low
Property	International (EMEA)	Med	Low	Med
Property	International (APAC)	Med	Med	High
Property	International (LATAM)	Low	Low	Med
Credit and Surety	International	Med	Low	Med
Casualty	International	Med	Med	High
Life	International	Low	N/A	Med

Section 7: Life and health markets

Please refer to Appendix II for the name of your local Willis Re expert representative and his or her contact details.

Exclusionary overview

Figure 20 sets out the most common situations with respect to exclusions by country for corporate and private plans for the life, health and medical insurance industries in the countries shown.

This high-level guide is provided for general guidance only based on terms and conditions commonly seen in the market. A company's own policy may differ, potentially significantly, so this guide should not be relied upon in making any decisions. Before taking any action, or declining to take any action, companies should review their specific policy terms in the context of their situation and obtain specific advice from their Willis Re representative or other suitably qualified professional.

- **Typically covered,** no specific exclusion
- **Mixed approach from insurers,** may be included or excluded
- **Typically excluded,** as pandemic or epidemic

[1] Exclusions may be applied for new policies effected from Feb 2020

[2] Exclusion under voluntary medical

Figure 21. **Corporate and private plan exclusions by country and industry**

	Country	Life	Disability	Medical
Asia Pacific	Australia			
	China			
	Hong Kong			
	India			
	Indonesia			
	Japan			
	Malaysia			
	New Zealand			
	Philippines			
	South Korea			
	Singapore			
	Taiwan			
	Thailand			
	Vietnam[1]			
Eastern Europe	Romania			
	Russia[2]			
	Turkey			
	Ukraine			
Global	Expat			
Latin America	Argentina			
	Brazil			
	Chile			
	Colombia			
	Costa Rica			
	Dominican Republic			
	Ecuador			
	Guatemala			
	Mexico			
	Panama			
	Paraguay			
	Peru			
	Uruguay			
	Venezuela			

	Country	Life	Disability	Medical
Middle East and Africa	Cameroon			
	Congo			
	Egypt			
	Kenya			
	Nigeria			
	Senegal			
	South Africa			
	UAE			
North America	Canada			
	USA			
Western Europe	Belgium			
	France			
	Greece			
	Germany			
	Ireland			
	Italy			
	Netherlands			
	Norway			
	Poland			
	Portugal			
	Spain			
	Switzerland			
	UK			

US life

Direct market view:
Data continue to emerge regarding COVID-19, and the range of potential outcomes remains very wide; however, we do know that life insurers will be impacted in multiple areas, outlined below.

Mortality impacts

Mortality projection impacts in the US have varied widely depending upon the source and timing of projections. Taking one scenario, we can consider a range provided by Dr. Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases (29 March), which estimated between 100,000 and 200,000 deaths in the US. This would represent a 3.5% to 7.0% increase in annual population mortality. The ultimate mortality impact may vary materially due to several factors, but this provides one perspective of the potential impact.

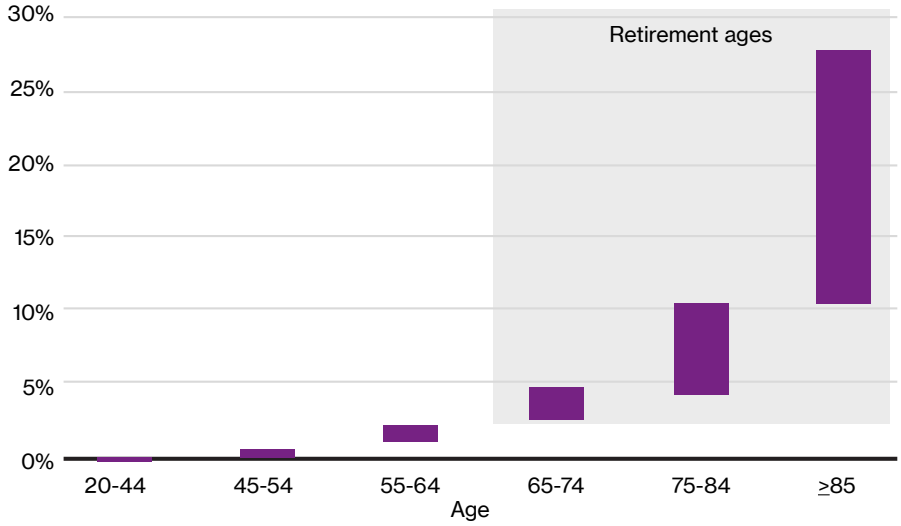
Specific to group and individual life insurers, mortality impact is anticipated to be much less than the population as a whole primarily for several reasons, including:

- Age distribution: Insured blocks of business have less exposure to older ages than the overall population.
- Underwriting: Both individual coverages and higher amounts of group coverages are subject to underwriting at time of issue.
- Actively at work status: The majority of group insureds are required to be actively at work for coverage.

To provide perspective on the impact that age mix can have on insured populations, in Figure 21, the chart on the left shows how significantly COVID-19 case fatality rates increase at retirement ages. The chart on the right compares the percent exposure at retirement ages for the overall population to typical group and individual insured blocks. Since the insured blocks have much less exposure at these ages, expected fatalities are much lower.

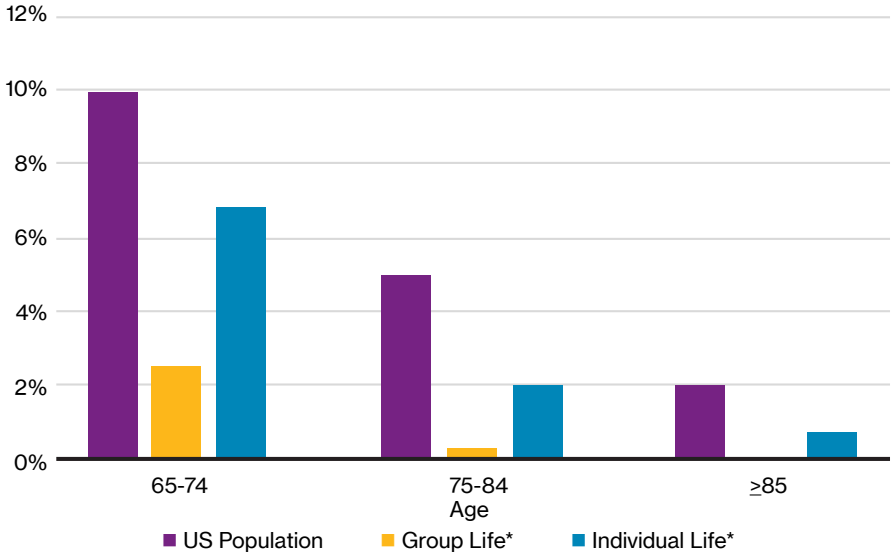
Figure 22. **COVID-19 case fatality rates and percent exposure at retirement ages**

Case fatality rate ranges by age*



*US CDC Mortality and Morbidity Weekly report- March 18, 2020

Percentage of exposure at retirement ages



Group and Individual distributions based on SOA 2016 Group and 2015 Individual Life Experience Studies

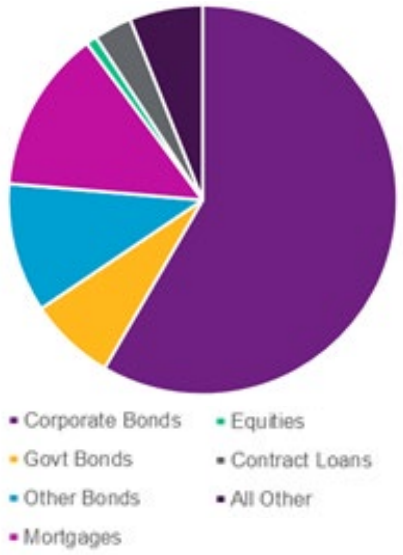
Note the impact of age can vary materially from company to company. Companies with higher concentrations of retirement exposure in their block will have greater risk of fatalities.

Invested asset impacts

In addition to claims, the asset side of insurer's balance sheets are also exposed to impact. As noted earlier in this report, there has been significant volatility in credit markets, with widening credit spreads (that is, falling corporate bond prices — US and European investment-grade bonds have been down between 10% and 15% year to date, and high-yield bonds have been down approximately 20%). Figure 22 illustrates the importance of corporate bond and other debt to the asset side of life insurer balance sheets.

In response, several measures have been enacted to support financial markets, including the Federal Reserve dropping its benchmark interest rate to 0%, the recent passage of the US$2.2 trillion CARES Act and the Federal Reserve announcing that it will purchase corporate bonds. The effectiveness of these measures is not certain.

Figure 23. **US life insurance industry investment mix**



Source: S&P Global market Intelligence, Life Insurance Briefing Book

As invested assets mature and need to be reinvested, there is potential for reductions in investment income. If interest rates remain low while the economy recovers, companies will not be able to achieve the same yields as in the past (without changes in investment strategy). While this risk varies from company to company, approximately a third of corporate bonds are expected to mature within the next five years.

Operational and other impacts

COVID-19 presents several additional challenges for US life insurers as well. Among these are the following:

- **Regulatory:** Regulatory changes continue to emerge from different states. New requirements range from extending grace periods to liberalizing paid family medical leave qualifications. Staying on top of these to manage the impact remains a challenge.
- **Persistency:** As employers reduce payrolls, group insurance coverage will be directly impacted while individual insurance coverage will be indirectly impacted to the extent that insureds become unemployed (and cannot afford to maintain coverage).
- **Underwriting:** Some companies have reported 30% to 50% increases in online life applications, but with increased risk from COVID-19, they have had to adapt their underwriting requirements.
- Claim management: There are new claim management challenges for life companies that also offer disability coverage. The availability of attending physician statements and other data required to evaluate disability is being disrupted in the short term. Over the longer term, there is a risk of an increase in subjective claims and a reduction in claimant recoveries as unemployment increases.

Cedent's view:
From a reinsurance viewpoint, there is minimal pandemic reinsurance coverage in the US market today. To the extent that companies view the risk of pandemics as more material going forward, there may be greater interest in new reinsurance structures that can provide pandemic cover. As companies change the treatment of pandemics within their ERM programs from an "emerging" risk to a "current" risk, there may be increased demand for reinsurance options to mitigate the risk. Cedents appear to be faced with more short-term funding needs that are not addressed through reinsurance.

Reinsurer's view:
Reinsurers continue to monitor emerging data closely but to date have not indicated that they expect capacity will be reduced to support existing coverages; however, reinsurers may increase scrutiny of program expansions that increase a cedent's reinsurance utilisation. While new capacity will still be available, it may vary by reinsurer, depending on losses incurred in other lines of business.

Some of the largest financial reinsurance markets are reporting that they expect demand for capital solutions to increase significantly once insurers have addressed more immediate priorities. Insurers are expected to look at improving their capital levels and capital management flexibility.

US health

Direct market:
Several impacts of COVID-19 will be felt directly by health payers, surely players or insurers the extents to which will depend on the length and severity of the virus and the duration of an economic slowdown.

Health insurers' most direct impact will be with respect to medical claims. This is (and will continue to be) experienced in two ways:

- COVID-19-related medical claims
- Medical utilisation drop-off due to members postponing planned care or avoiding care altogether

COVID-19-related medical claims are projected to be a significant cost to US health insurers. One estimate, provided by Covered California, indicates that the claim impact could vary widely, from 2% to 21% of annual written premium. The ultimate impact will depend on several variables, specifically:

- Geography – exposure relative to the most densely populated and most infected areas, as the spread of COVID-19 in the US has been concentrated in specific geographies. To the extent that a line of business has concentrations in higher infection rate areas, there is greater risk of adverse claim experience.
- Duration of pandemic (and follow-on events) – the extent of public cooperation with and the effectiveness of mitigation efforts will have a direct impact.
- Hospitalisation admittance rates/ length of stay – what percent of infections will be severe enough to require an inpatient hospital stay? What will the average duration be?
- Intensive care unit (ICU) admittance rate – within the hospitalised population, what percent will require the ICU? What is the average ICU length of stay?
- Mix of business – older populations with comorbidities will require disproportionately more hospitalisations. Medicare Advantage populations will be impacted more severely.

Equally uncertain is the offsetting impact of the current drop in medical utilisation. This saving is being experienced across all categories of medical care and could easily offset COVID-19-related claims. When members begin to utilise medical services again there will be significant pent-up demand and higher-than-planned utilisation. Operationally, however, providers will not be able to keep up with this demand, so we would expect that not all delayed services will be rendered in 2020.

The potential for additional waves of COVID-19 infections, subsequent to the current one, does exist and should be considered relative to pricing and forecasting efforts for the rest of 2020 and 2021.

On the revenue side, there could be significant membership flux related to several factors, such as:

- Employers trimming payrolls due to a recession
- Business failures, which will lead some groups to terminate coverage
- Membership lapses on the Individual Exchange

Offsetting these factors somewhat will be employers' desire for stability leading into 2021, which should make them less likely to move coverages. While this is positive for insurers' case persistency levels, it logically will produce a headwind for new sales.

Given the uncertainty around claims, membership and pricing, there is potential for continued volatility in 2021.

Figure 24. **COVID-19 exposure**

Source: Johns Hopkins University

Cedent's view:
Most, but not all, health reinsurance purchasers are protected by per-claim excess of loss (XOL) policies. Depending on membership levels, many commercial plans reinsure at a deductible greater than all but the most severe COVID-19 ICU claims. While there will undoubtedly be some claims in excess of XOL deductibles, the claim recoveries are expected to be limited.

For Medicare Advantage plans, many cedents reinsure at lower deductibles than commercial plans, given claim size differences between the two populations. Given this, and the assumption that severe COVID-19 claims are impacting older populations at a greater rate, there is greater potential for claim recoveries for these plans. However, a counterpoint to this assumption is the higher mortality rate of older COVID-19 cases, which could reduce the length of hospital stays. Geography is also a key variable, as the severe breakouts of COVID-19 are geographic in nature, as are Medicare Advantage plans.

Regarding 2021 renewals, many health plans will be eager to achieve stability but will also be dealing with significant changes in membership requiring a fresh look at risk tolerance and reconsideration of reinsurance structures. It has also been reported that more health carriers will be seeking capital motivated reinsurance (financial reinsurance) options to improve their capital positions and flexibility. Many health plans will be inclined to accept modest renewal increases in exchange for the stability of renewing with their incumbent carrier.

Risk committees will be more engaged than ever before. Reinsurance retentions are expected to remain relatively constant and interest in reinsurance does not seem likely to drop in 2020.

Reinsurer's view:
Market capacity should remain strong, but the cost of reinsurance could also be affected by how deeply multi-line reinsurers are impacted adversely on other P&C lines of business.

The health reinsurer exposure to COVID-19 claims is limited for the reasons outlined above. However, reinsurers writing the following products could have some unexpected exposure, depending on structures:

- Quota share
- Aggregate
- Provider risk
- Stop loss

Prospective reinsurer capacity and pricing is expected to depend on current product exposure to COVID-19, anticipation of subsequent years' recurring events (though exclusions can limit exposure), losses on non-health product lines, overall economic conditions and reactions of health reinsurance peers.

International life

The primary mortality market is, by definition, long-term business. There is no general exclusion of pandemic risk (except in Brazil), and we would not expect the market to change because of COVID-19. The demography of the population most at risk has very low penetration of life insurance, so they are unlikely to pose any real threat to the mortality market.

From a reinsurance perspective, in general proportional mortality covers will follow the fortunes of primary insurers. Non-proportional covers, on the other hand, tend to be structured as extreme mortality stop loss reinsurance, for which capacity is still available but at ever-increasing prices.

COVID-19 is having a positive impact on the bottom line of insurers in the longevity (annuity) business, since people are living shorter lives than expected once infected by the virus. Here, the converse of the case in the mortality market is true: penetration is higher among the population who are most exposed to the effects of the virus.

The likely impact on the international health market is difficult to assess at this stage since outcomes are very dependent on the state of a country's national health system. Furthermore, this class is almost entirely retained net and unreinsured.

The main impact for participants in the life insurance market is on the asset side, discussed in Section 3 of this report.

Section 8: Non-life markets

Please refer to Appendix II for the name of your local Willis Re expert representative and his or her contact details.

North America

Health care

Healthcare liability insurers are generally seeing an overall decrease in exposures as insureds have curtailed the delivery of non-essential healthcare as a result of COVID-19. Current efforts are focused on how to respond to the temporary shift in exposure which is widely varied.

There is generally less liability concerns as respects providers, however there is heightened awareness on the potential impact to facility business to specifically include long term care. Some common concerns include the potential for Batch (related) loss events, general liability and employer liability exposures related to infection spreads from visitors and employees, childcare exposures, healthcare provider shortages, impact of crisis delivery models (temporary or repurposed care facilities), increased telemedicine, equipment shortages and supply chain issues. The Federal Public Readiness and Prepared (PREP) Act, various legislative initiatives being introduced at the state level as well as other existing liability protections are anticipated to provide some mitigation to healthcare liability.

Direct market:
Rate levels will vary across the industry depending on the line of business. Projected physician rate levels have adjusted downward to flat pricing with a significant number of special pandemic credits being applied. Rate levels on LTC and hospital business are likely to continue their upward trajectory. These rate changes are more likely to take the form of structure adjustments (increased retentions, reduction in limits) as depressed revenues will impact clients' ability to pay larger premiums for similar products. Renewal and new business appetite remain largely intact for most practitioners with limited sub-segments (LTC and hospital entities) experiencing temporarily heightened caution.

Cedant's view (original business):
Focused on supporting healthcare providers combatting the current crisis.

Assisting provider efforts to address immediate needs of voluntary healthcare providers coming out of university or retirement to assist, increased use of telemedicine, and temporary response facilities and services. Limited immunity protections exist for volunteers, and Cedants are supporting further expansion of immunity protections.

Providing premium relief/delay in accordance with state departments of insurance to impacted providers who are experiencing practice interruption.

Evaluating potential areas for claims developing from delay of "elective" or "non-essential" services, community spread, or facility capacity availabilities.

Hopeful for a reversion of "social inflation" and jury attitudes in the future following COVID-19 experiences.

Current reinsurance structures are largely effective in matching the exposures and risk appetite of clients, with little anticipated change in the future.

The quality of subscribing reinsurers and their ability to pay losses remains strong.

Belief that capacity will remain intact although additional pressure on its cost in certain sub-segments is anticipated.

Reinsurer's view:
Reinsurers are engaging cedants in order to evaluate their exposure to the COVID-19 pandemic.

Healthcare facility business, long term care facilities in particular are a major focal point of reinsurers.

Aggregate coverage will be closely scrutinized as respects COVID-19 pandemic losses on future placements.

Reinsurers are seeking to understand the impact of reduced subject premium as cedants address reduced exposure from practice interruption.

Reinsurance terms were strengthening before the COVID-19 pandemic and are expected to continue.

Property

Direct business:

This write-up will focus mainly on North American commercial lines property due to the exposure associated with BI. There are not many applicable property coverages for personal lines, and the focus of personal lines has been mainly around credit risk.

The North American commercial property market can be segmented into three general buckets for pandemic coverage in the underlying business: insurers that offer affirmative coverage through a thoughtful underwriting strategy, insurers that apply specific exclusions and insurers that are silent on coverage.

1. **Insurers that offer affirmative coverage through a thoughtful underwriting strategy –** These carriers are specifically underwriting the exposure and typically offering a form of special peril BI coverage for pandemic. In this case, the insurer is managing exposure through sub-limits and risk transfer and providing the coverage at a distinct price.
2. **Insurers that apply specific exclusions –** An example of this is Insurance Services Office's (ISO's) exclusion of loss due to virus or bacteria. This is a standard ISO exclusion and broadly used across the US property SME and middle market segments. For large complex accounts, there is typically a manuscript exclusion applied where coverage is not affirmative.
3. **Insurers that are silent on coverage –** While these insurers are not specially excluding pandemic, coverage for BI typically only applies as a result of physical damage.

Given the current and ongoing situation with COVID-19, reactions from insurance companies have varied significantly. This is being driven mainly by commercial lines due to the uncertainty around BI and the current regulatory/legal environment. As a result, a significant portion of all commercial lines carriers have tightened their underwriting due to COVID-19. Most carriers are looking to specifically exclude COVID-19, or add or enhance current virus exclusions, while some are looking to expand to an absolute exclusion for communicable disease or pandemic on the underlying policies at renewal. Subsequently, many shared and layered programme towers have either removed sub-limits or have significantly reduced them due to a decline in carriers' appetite.

The largest uncertainty around the COVID-19 crisis is the fluid legal environment. Although carriers are receiving numerous claim notifications, losses are expected to be minimal, based on exclusions or physical damage requirements. However, if state or federal proposed BI legislation (NJ, MA, OH, PA, LA, NY, CA and SC) pass, the figures would be expected to increase significantly. Most trade practices and carriers, however, do not believe that legislators will be successful in providing retroactive coverage without some sort of federal backstop. As a result, all carriers continue to write business, but there are carriers that have placed moratoriums over writing nonessential businesses or new accounts with large BI exposure.

The rate environment has continued to charge ahead and is persisting during the COVID-19 crisis. These positive rate movements were gaining significant momentum prior to COVID-19, and no large shift is expected as a result. For premiums, most carriers have not been anticipating large fluctuations in their original premium estimates at this time. However, the potential for regulatory and legislative impact is a concern.

For small commercial and personal lines, credit risk is something carriers are watching due to the impact of shelter in place on their typical insureds.

See Appendix I for commentary on the legal landscape in the US.

Ceded business:

At 1 April, several reinsurers sought to impose COVID-19 exclusions at renewal. When a carrier was offering coverage affirmatively, reinsurers pushed to put an exclusion in the reinsurance contract at renewal. In cases where the underlying policy had an exclusion for a pandemic-type event and carriers were transparent with their approach, reinsurers were more willing to follow the exclusion in the underlying wording. There was a wide range of proposed exclusions by reinsurers, with differences ranging from specific nuances for excluding loss to COVID-19 to an absolute exclusion for all pandemic events. The majority of the push for exclusions appear to be coming from UK and Bermudian markets.

Client resistance to a pandemic exclusion in the reinsurance contract to date have revolved around:

1. Commercial exclusions in the underlying policy
2. In the event of regulatory or judicial invalidation, clients expect the follow the fortunes to be invoked
3. The uncertainty of COVID-19 exposure is commercial lines-focused and should not be broad-brushed to personal lines carriers

During 1 April renewals, reinsurers found no exclusion, or an exclusion per the underlying wording, acceptable, where the cedent was transparent with its exclusion approach and the wording has been deemed sufficient, or the cedent was sub-limiting exposure with a thoughtful underwriting strategy and was able to quantify its exposure.

Although there are concerns in the commercial market over ISO virus exclusions holding up or the requirement of physical damage, the legal environment is evolving; therefore, since it is too early to tell what losses will arise, reinsurance pricing has not accounted for this possibility.

Casualty

Direct market:

We are not anticipating a material increase in claim activity, but we may observe a slight uptick in defense costs.

Underwriting the financial strength of insureds and analysing the portfolio risk to the anticipated economic slowdown is becoming more important for companies to react accordingly.

Impact on business plans is expected to be low, with the exception of energy casualty. For middle market, national and excess and surplus (E&S), business plans are expected to be driven more by rate requirements than exposure. Construction work might be affected if workers do not show up for work. Exposure base for upstream leaseholders are oil well lease assets, so exposures remain fairly flat.

For writers of smaller insureds, pandemic could affect business plans as revenues drop and small business firms close, potentially extending to mainstream business (depending on the legislation being considered).

Reinsurer's view:

Some reinsurers are starting to ask for client positions on COVID-19 exposures.

Exclusions:

Some Lloyd's syndicates are stating that an exclusion is required on reinsurance renewals, which felt like a knee-jerk reaction to the memo circulated by Lloyd's.

Some carriers have confirmed they will be adding an exclusion to their inwards policies moving forward.

Expect exclusions from others in the future, although these are still being discussed. In part the concern about putting them out too early is that someone may view that they have coverage prior to virus/pandemic exclusion being on the policy. Writers of hospitality business are the most at risk.

Workers' compensation

Direct business:

Coverage for occupational disease has always been in workers' compensation policies, subject to regulations that restrict exposure to those that are peculiar to the employer (policyholder). There is concern that this standard could be loosened but, so far, there have been no indications of any dramatic reforming of regulatory definitions of coverage.

There is a widespread realisation that payrolls, and therefore premium, will dramatically decrease, especially within portfolios with significant job classes related to discretionary income (for example, restaurants, hotels, automobile, all other travel).

By current definition and past history of flu epidemics, claim cost should be modest with the exception of portfolios with heavy health care or first responder exposure.

On pricing, expect regulatory pressure to keep rates low. Coverage has always been unlimited and would be expected to remain the case in the future.

Cedant's view:

Workers' compensation, historically, has a relatively low claim severity. Combined with the fact that there is limited scope to aggregate individual losses within standard excess of loss coverage, recovery potential is not expected to be significant.

April renewal quotes and firm order terms (FOTs) were out before the crisis had escalated to the current circumstances; therefore, mid-year renewals are likely to be more complex to navigate. Where do reinsurers invest new money when they make this long-term capital commitment? Reinsurers will need to clearly demonstrate an underwriting return, and managements may view the long tail in a dim light.

Reinsurer's view:

The main concern seems to be a reduction in premium volume driven by reduced workforces. There was a small pocket of reinsurers not looking favourably on requests to reduce minimum and deposit premiums as a result of highly uncertain exposure at the recent April renewals.

Firming beyond terms and conditions expected during mid-year renewals, pricing is likely to increase. There are negative implications for the demand for working layers in particular, where any COVID-19 claims will likely end up.

Workers' compensation cat is not likely to be impacted significantly, as many reinsurers view this as a very profitable line of business and can be underwritten on an annual basis.

Exclusions:

There was a late play by reinsurers to add COVID-19 exclusionary language after FOTs issued. Some reinsurers acquiesced and others landed on compromises that did not materially impact client's business, with associated reductions in authorised line, while a third group non-renewed as a result.

Financial lines

Direct market:

The general level of concern for US financial and professional lines is deemed to be low, at this stage. There is an expectation of an increase in claim frequency and likely a handful of unique cases with clear loss potential (ie cruise ships, perhaps some employment practices liability insurance [EPLI] issues) but otherwise, the loss impact from this event is expected to be confined to defence costs that may bleed into the primary layers.

The main impact on business plans is coming from reduced M&A activity, leading to reduction in volumes in the transactional risk liability (TL) market. There is no clear feeling yet about how much the TL market is estimated to be down year on year. We may also see some reduction in other lines, but this would be indirect (eg from headcount reduction).

A couple of direct D&O claims have been reported so far (a cruise company and a pharmaceuticals company); broader claims are likely to be reported in D&O as a result of the market drop but are not expected to be an area of significant loss dollars.

Other potential areas for claims concerns are EPLI – issues such as mistreatment or mishandling of employees during work-from-home transition, privacy issues of those infected, and/or poorly handled layoffs; mass layoffs would exacerbate this scenario. Another area of loss potential is insurance agents E&O and suits relating to the lack of coverage for COVID-19.

Original rates: The US financial and professional lines market has been hardening for at least the last year and was expected to continue into 2020 – with no change in expectation of a positive rate for 2020. With regard to coverage, a possible shift that may arise is a reduction in limits purchased by SMEs looking to preserve cash.

Cedent's view:

Currently, there are no serious concerns about recoverability under existing reinsurance arrangements and as a result no apparent need to restructure programmes.

Reinsurer's view:

There is a general agreement that there will be an uptick in claims, without any significant impact on the market as a whole.

The only amendments to coverage or wordings appear to be driven by a handful of Lloyd's syndicates who are seeking changes across all lines of business, seemingly without much thought about the covered exposure. To date, these requests for exclusions have been removed in the final negotiations.

The general investment environment is not conducive for long-tail lines. Occasional feedback from a few markets is that the underwriting margin may have to increase to cover cost of capital.

There is no change in risk appetite and some early indication that financial and professional lines deals are going to be quoted early given that reinsurers do not view them as being directly impacted by COVID-19.

Mortgage

Direct market:

The two main drivers of mortgage defaults in the US are unemployment and home prices. Unemployment creates situations where people can't pay their mortgage, although it takes several months to cause defaults. Home price drops create incentives for people to strategically default if they owe more on the house than it is worth.

As mentioned, high unemployment normally leads to an increase in mortgage defaults. The COVID-19 situation is different because of government intervention. Both Freddie Mac and Fannie Mae have broadened their forbearance rules (believed currently to be 12 months for COVID-19), among other measures to prevent defaults.

Home prices don't seem to be going down. The expectation is that they will remain flat because there won't be many home sales for the time being. In the absence of government intervention, this would have been a major problem for the mortgage insurance line of business. The situation is comparable in other countries outside the US. It is unclear what will happen going forward.

There is concern that private mortgage insurers will have increased losses due to COVID-19. These are the riskiest mortgages because of the high loan to value.

Cedent's view:

There is an initial expectation that claims arising directly from the crisis will be low, but this situation could certainly change over time. Some cedents are looking to bind coverage as soon as possible after receiving authorisations, to minimise any uncertainty in their programme placement.

Reinsurers' capital position and ratings are a concern. Any significant drops in capital or rating could lead to reinsurers no longer being approved. These could also lead to reduced reinsurer appetite for mortgage business.

There is some concern that some cedents have reached their risk limits with some reinsurers. This was true prior to COVID-19.

Reinsurer's view:
Reinsurers' views are varied: most seem to think it won't affect them too much. On a recent Australian mortgage reinsurance transaction, only one major incumbent non-renewed, before the crisis.

Many reinsurers have slowed down writing credit business in general, including mortgage. We have not seen many mortgage deals coming to the market right now. This is the time when Freddie Mac and Fannie Mae would issue some credit risk transfer deals. It appears they are taking a break from issuing deals. We would assume that pricing would be quite high for a deal issued right now. Most cedents would not want to lock in a high price that could carry forward to future deals.

Surety

Direct market:
The ultimate effect of COVID-19 on surety is unknown and speculative; however, there are some certainties that are clear. The virus is having – and will continue to have – a negative impact on the overall global economy, resulting in an increase in operational, financial and performance risk for principals. The loss potential is expected to be directly correlated to the length and depth of the economic slowdown and principals' ability to weather this period of inactivity.

Bonding activity is expected to be delayed for particular segments and geographies, which will have a direct impact on revenue projections for insurers operating in this line of business. Given the credit nature of the product, clients are consistently underwriting the creditworthiness of the principals within their portfolios and actively managing their aggregations to certain market segments.

The main contributors to increases in potential losses are not directly related to the pandemic itself but rather from the economic impact causing project delays, disputes and project defaults. Some factors to consider in assessing loss potential are:

- Supply chain disruption, material and transportation delays
- Additional pressure on a tight labour market due to containment and preventative measures to minimise outbreak spread
- Inability to access restricted areas where work is to be completed
- Heavily indebted principals with limited liquidity or access to capital

Force majeure clauses to allow for extended delivery or completion time should help mitigate the risk with these scenarios.

In addition to construction-related activities, other commercial surety performance obligations to deliver goods and services will see heightened exposure to risk, with the following market segments particularly exposed at the current time:

- Oil and gas, coal: heavily influenced by commodity prices
- Hospitality, travel, retail: workforces are heavily impacted
- Companies with highly leveraged balance sheets leading to increased bankruptcy risk (eg private equity-backed companies).

Cedent's view:
Clients have been hyper-focused on any concentrations to the hardest hit segments of the economy and on assessing an individual credit's ability to survive a prolonged downturn in the economy.

Sureties continue to engage agents and principals to help ensure bonded exposures are protected with proper language in the underlying contracts that addresses project disruptions related to COVID-19.

Current reinsurance arrangements provide an appropriate level of coverage and recovery prospects, so they would be unlikely to adapt any time in the foreseeable future.

Any possible change in buying behaviour will depend on whether losses (if any) are characterised by systemic correlations or isolated to more severe events.

Market capacity is largely provided by strong global reinsurance partners, and the financial strength in aggregate still appears to be adequate, so there are no material concerns of this nature at this stage.

Reinsurer's view:
There is heightened sensitivity to all credit lines as a direct result of COVID-19, with select markets stating that they have increased underwriting scrutiny and will be highly selective in the assumption of any new credit exposures.

Any changes to the types of coverages offered and purchased in the surety market are not anticipated, although perceived correlation between credit lines and a reinsurer's asset risk has led to heightened sensitivity. This could manifest itself through pricing or, more likely, through availability of capacity.

Exclusions:
Since the impacts of COVID-19 on potential losses are indirect through broader economic forces, exclusionary language has not yet been presented as a material consideration for reinsurance placements. Support for current clients and existing portfolios at pre-pandemic coverage terms and conditions has not wavered.

Global specialty and sector-specific

Specialty short tail

Direct market:
Insurers and reinsurers are still assessing the potential exposure to COVID-19 claims, particularly in relation to BI limits in their property portfolio. It was business as usual otherwise at the 1 April renewals, which followed a similar trend to those at 1 January. Original income estimates are under scrutiny as many policies are expected to lapse due to business closure, a situation that is particularly acute in the SME sector.

Since 1 April, many underwriters are insisting on Lloyd's Market Association (LMA) 5393 or equivalent policy language in order to clarify exposure. Markets are also trying to exclude any non-physical damage coverage and reviewing BI extension sub-limits that might provide communicable disease or pandemic coverage.

The London market reaction is split between underwriters who are accepting this is another big loss event to contend with, in the same way as other large global cat losses, versus others whose view is far more devastating, and there is a suggestion that a degree of panic is being seen in the property market for the first time really since 9/11. The accident and health (A&H) market is behaving in an orderly fashion, despite a sense of impending losses in the market.

Cedent's view:
Requests for the inclusion of exclusionary language is a concern, particularly for classes that are predominantly placed on a losses occurring during (LOD) basis.

Political and credit risk portfolios are currently facing heightened event risk from both COVID-19 and the fall in oil prices. A drop in oil price was expected due to the COVID-19-induced economic slowdown, but the breakdown in Russian and Saudi Arabian relations, causing the chaotic increase in supply and thus the sharp drop in prices, has caught the market by surprise. The net effect is a potential withdrawal of capacity from the market until the longer-term impact of the virus is better understood.

In the A&H market, pandemic has traditionally been identified and specifically priced for, and exclusionary language is well developed and clear. Travel losses are anticipated although to date these appear modest, as loss mitigation is employed by original insureds – although it's very much in the early days. In many cases, cedents have not purchased pandemic-specific coverage due to cost but are now keen to obtain quotes, including pandemic coverage, even where this coverage is going to be two to three times the previous level of quoted prices.

Downstream energy
With regards to COVID-19 infectious disease coverage, this is not broadly recognised as a physical damage peril in the downstream energy market in the oil and gas space, and the majority of insurers would therefore not offer BI cover without a physical damage trigger.

However, there are infectious disease extensions in some specific regions, mainly Asia Pacific, which generally afford coverage for interruption or interference to business by order of government, the disease manifesting by any person at the premises or within five kilometers of the premises. The coverage is sub-limited, typically below US$10 million for 100%.

Going forward, markets are critically looking at these extensions and are actively attempting to remove this coverage on any new business and renewals. The LMA 5391 coronavirus exclusion is gaining traction within the downstream energy market.

For power and utility insurances, carriers overall do not view COVID-19 as a major exposure for two key reasons:

- Most major buyers of insurance in this space are critical infrastructure companies providing electricity and gas, so they have not shut down but transitioned to remote working conditions. They continue to deliver electricity and gas to their customers.
- Like oil and gas, BI and contingent BI coverages require physical damage by a covered cause of loss.
- Two claim scenarios do, however, appear possible:
- Where this is COVID-19 at an insured location
- Businesses that were closed due to governmental order (ie civil authority)

With respect to the scenario where the virus is present on property, it appears unlikely to exceed the deductible of programmes, and waiting periods are in place on original policies in addition to the fact that it does not constitute a physical loss. The property can be cleaned and disinfected before use, thereby reducing the exposure to any potential physical loss further. In the second claim scenario, the governmental order is for the health and safety of the public and is not the result of physical damage to covered property.

Reinsurer's view:
In general, no major capacity withdrawals or change in supply for the risk and cat on D&F and E&S markets are expected, nor for other specialty lines such as energy. There is a potential for some post-April renewal hardening in the market, but the extent of any rate increases is unclear at this stage. Conversely, the political risk market is in a state of flux, including sub-sectors such as trade credit, political violence and contingency.

New realistic disaster scenarios are being designed for political risk and credit; examples below are provided by market participants:

- Downside scenario: epidemic lasting around three months in any given country, with associated economic stress peaking over the following year
- Stressed scenario: as base downside scenario, but epidemic conditions lasting around six months, causing additional stress for lower-rated obligors
- Pessimistic scenario: continuing for 12 to 18 months. The longer the prevalence of quarantine and restrictions on movement, the higher pressure on obligors' liquidity will be (due to lower sales), and workers not earning wages will reduce overall consumption levels. While government action, either directly or through the banking system, is expected to be supportive, more obligors may default if conditions don't improve, particularly if they are highly leveraged private enterprises that are not large employers.

In the downstream energy market, reinsurers' default position at the current time is to request full exclusionary language for COVID-19 and or infectious disease; however, with detailed feedback and disclosure of underwriting guidelines from cedents, we have been successful on pro rata and RAD treaties at 1 April renewals in pushing back on these requests.

For LOD and on cat placements, however, this has proven more challenging, but there have been instances where bespoke exclusionary language has been brought in as a compromise and only in respect of polices written after 1 April 2020.

In the A&H reinsurance market, coverage is often limited to 'accident only' and may carry a specific epidemic/pandemic exclusion. Reinsurers offer various pandemic products, and specific cover is available to protect cedents against pandemic risk, with pricing options to include/exclude COVID-19.

For Medical expense (re)insurers, whilst initially insisting on COVID-19 exclusions being included in new and renewal business, have now realised this is both politically and economically impossible and have relented and are now including this coverage.

Most Medical (re)insurers believe that the relative low cost of COVID-19 claims in the vast majority of individuals will be offset by the lower-than-normal procedures that are not taking place during the current pandemic. Reinsurers believe increasing specific retentions above US$50,000 on self-funded business will reduce potential claims further.

Retrocession

COVID-19 is proving to be a further catalyst for all round market hardening, almost irrespective of line of business. Working capital is seemingly becoming a bit scarcer. Balance sheets have taken losses on the asset side; share buybacks have been put on hold, and reduced liquidity in financial markets is resulting in cost of capital going up for reinsurers.

Market dynamics:

Traditional retrocession capacity remains relatively unaffected in terms of available capacity for renewal business, but there is increasing concern of whether COVID-19 losses will filter through to the reinsurance and retrocession market given the mainstream press coverage on BI losses to the direct insurance market and the emerging political situation.

ILS capacity, which has dominated the retrocession market in recent years, with an approximate market share of 55%, is expected to be constrained in the short- and medium-term. There have been significant outflows of capital in the past 12 months due to negative investor sentiment and adverse loss frequency in recent years, some of which was able to be replaced; however, the recent inflows have come from a different type of investor (private equity/hedge funds) who, given the stable macroeconomic environment at the time, saw opportunity in volatile catastrophe retro at high returns (greater than 15% return on capital). These investors are now expected to halt inflows into the ILS market and seek better returns elsewhere as the new macroeconomic environment leads to opportunity for higher returns outside of ILS.

The majority (approximately 85%) of retrocession placements take place either at 1 January or to a lesser extent at 1 April. This will provide both cedents and reinsurers the opportunity to fully digest the impact from COVID-19. Midyear reinsurance renewals in Florida and the small number of retro placements occurring at this time, however, do not have such luxury. Total capacity volumes available from ILS funds for the mid-year renewals remain unclear, as the extent of redemptions affecting ILS funds is not confirmed.

There have been positive signs in both the cat bond and industry loss warranty markets where capacity is still available, but we are starting to see a gradual uptick in pricing to cater for buyer demand, which has been brought forward from the traditional buying time of post 1 June placements.

ILS (cat bonds and sidecars)

Market overview:

Short term: an increase in the secondary market sale activity in the cat bond market, no immediate impact on the sidecar market

In the cat bond space, most programmes are not yet directly affected by COVID-19. The ones that are most at risk are a small number of extreme mortality and morbidity cat bonds, one of which is sponsored by the World Bank; however, the broader fixed income market sell-off has distracted some investors, who are now tempted to monetise their cat bond portfolios.

Dedicated ILS investors have had limited redemptions to date. This may be due to the resilience of their mandates, or it may result from their fund structures that seldom allow for quick and large capital withdrawals.

Some multi-strategy investors (ie those not only investing in ILS) have redeployed capital elsewhere in assets classes that have been severely dislocated. To be clear, neither the ILS market or the broader fixed income and securitization markets are anywhere near as dislocated as circa 2008.

These secondary sales lead to an orderly sell-off that now seems to be reaching an equilibrium with additional buyers supporting recent levels. These levels translate to higher implied risk spreads, which will likely impact new primary issuance. With stability, sponsors can now begin to rely on a more predictable source of capacity for primary issuance.

The vast majority of the sidecar market does not renew until 1 January; there is limited impact of COVID-19 in the immediate short term since most positions are buy and hold (contrary to the cat bond market) and the collateral is locked up until at least the end of the risk period.

Medium term: sufficient availability of cat bond capacity but less certainty on spreads

More than US$4 billion of aggregated cat bond limit is scheduled to mature in Q2 2020, which will need to be replaced. New issuance activity anticipations are promising, and ILS managers should have sufficient liquidity to absorb these, unless the total issuance size is significantly greater than the freed-up US$4 billon. There is more uncertainty in terms of spread expectations, as this will in part be dictated by the evolution of traditional reinsurance rates, with investors always keeping an eye on them when setting their own targets.

Long term: positive outlook for the cat bond market, less visibility to date on the sidecar market

The current financial crisis is re-emphasising the value of portfolio diversification through ILS. As expected by theory and experience ILS outperformed many other portfolio investments on a relative basis at a time of broader market turmoil. Consequently, end investors are likely to view the behaviour of the cat bond market positively after the COVID-19 crisis. This may result in potential increased allocation to the space in the future.

In addition, some end investors view the relative contract certainty in the cat bond market more favourably than in the past. In contrast, the impact of COVID-19-caused BI on other ILS products is far less clear. Investors fear this lack of clarity may result in both unanticipated losses and/or substantial trapped capital for other ILS products.

Ultimately, investors will decide on their allocation to sidecars for next year based on the relative performance of their own investments against other investment opportunities (within or outside the ILS space) at the time of renewal. Whether the COVID-19-related BI losses will impact the sidecar market or not will meaningfully impact investors' long-term confidence in the product – and there are real worries on the part of investors of this possibility. Rather than, or in complement to, a change in capacity, investors may be pushing for tighter terms and conditions, a trend that started at the end of 2018 and that was confirmed at the 1 January 2020 renewal already.

Aviation

Direct market:

Passenger traffic has always remained resilient in the face of external shocks. COVID-19 combines simultaneous aviation demand and supply side shocks like no other event post-WWII. The impact on the aviation industry, by extension, will be defined by the extent of government intervention.

A situation shifting by the hour, it is expected that the industry will be protected by many governments around the world with perhaps the largest threat to airlines existing in the European market. Some believe that COVID-19 could permanently impact future air travel demand from a climate change perspective.

Total impact is estimated to be a reduction of approximately 4.5 billion passengers over the next 10 years, but we expect growth to eventually return to the long-term upward trend. Our current estimate for impact to 2020 is a –34% change in passenger numbers compared with 2019. Exposures are expected to return to 2019 levels in 2023.

Cedent's view:

Original business volumes are likely to be affected, but the extent is as yet unknown. This drop in passenger numbers may affect the upturn in the market. Our current best guess is that premium could change –15% from 2019 estimates, and for 2020 a –14% impairment from previously expected levels assuming rating momentum continues.

Clients have some minimal concerns about claims arising under the policies issued, but we believe there to be no exposure to the virus at this stage. Client and broker behaviour remain unchanged with submissions, coverage and pricing remaining normal, for the time being.

Reinsurer's view:

It's too early to tell what impact COVID-19 will have on the future hedging strategies of protection buyers, but they are appropriate so far, with stable client appetite and the perception of reinsurer credit risk not yet materially different.

Generally BI coverage is not included within aviation policies. There may, however, be some exceptions to this, although any such coverage is likely to be heavily sub-limited and, from an excess of loss point of view, claims would be unlikely to reach programme attachment points.

Marine and energy

Marine – direct market

Marine industries will be more concerned by the economic impact of the various lockdowns than the pandemic itself. The transportation industry will clearly suffer from the reduction in trade and economic output.

A certain level of insolvencies, or at least vulnerability to take-over, amongst weaker players seems likely. With balance sheets impaired, there may be some reduction in risk tolerance but little cash to pay for it.

There are certain sub-segments that will be hit harder than others.

The cruise ship industry is not just exposed to a short-term drop in passenger numbers but also a potentially fundamental shift in demand away from enormous vessels where large numbers of people are confined together.

Industry participants carrying large levels of debt will be exposed; this has historically included a major proportion of shipbuilders, as well as fleet operators who rely heavily on bank finance to purchase vessels; some smaller oil companies may not survive. However, fundamentally, the marine industry will follow any medium-term recovery in economic activity.

There is a high level of conjecture around what types of claim may be recoverable, but in principle the marine insurance markets require some kind of physical loss or damage to trigger a recovery (though this differs for protection and indemnity (P&I) where liability towards people – crew and passengers – is an insured interest likely to result in significant recoveries). At the current time, the expected claims activity is in respect of specialist areas:

- P&I risk losses, including crew and passenger liability, cruise cancellation
- Crew repatriation
- Extra expense extensions, including cargo forwarding charges
- Certain perishable goods, notwithstanding a high degree of uncertainty around coverage

Outbreaks of disease amongst the crew of commercial vessels at sea raise important questions over not only financial liability of P&I providers but also vessel safety.

Illness to workers may compromise safety and/or efficiency of ports and terminals, with a potential implication for risk management practices. There may also be delays at terminals due to additional measures being imposed by authorities for health and safety or customs checks.

If manufacturing output is down amongst large swathes of the economy but the product hasn't sold and has instead accumulated in a warehouse, this will likely change the premium dynamics in respect of stock throughput business.

Upstream energy – direct market

At the beginning of 2020 Brent Crude, the global benchmark, was trading at almost US$70 per barrel (pb). At the time of writing it is just above US$31 pb having been as low as US$23 pb, the lowest since 1999.

In recent years, oil producers have faced a spectre of depressed demand that could upend the industry. All of a sudden, the wraith has materialised, not out of concern for the climate, as oilmen feared, but because of COVID-19. Crude fuels the movement of people and goods around the world. A lot of this has stopped as governments limit travel and other economic activity to contain the pandemic. Oil demand has dipped in only two of the past 35 years. In the first six months of 2020, it may plunge by more than 20%.

The coinciding dispute between Saudi Arabia and Russia, and their battle for market share, couldn't have come at a worse moment. The recent historic agreement between OPEC and other oil producers to reduce production by 10 million barrels per day (about one-tenth of the Worldwide daily consumption) could assist, but it is unclear whether they will succeed in boosting crude prices. America helped negotiate the deal, the largest ever voluntary cut. The deal's two-year duration could support oil prices as demand picks up, but only if producers abide by its terms. In the past, Russia, Iraq and other big producers have regularly exceeded their quotas. Other countries may rebel too: Mexico's reluctance to agree to the cuts almost derailed the deal entirely.

If an exploration and production company cannot 'make it' at US$20 to US$30 pb, then is 'big oil' dead? Possibly, but not immediately. Energy was the worst-performing sector in the S&P 500 index in four of the past six years. According to Goldman Sachs, prices in parts of the world may fall below US$10 pb or even turn negative as producers pay to have their oil taken away rather than shut in wells.

When the world economy begins to reopen after the pandemic, it will find the oil industry looking different. COVID-19 will fundamentally alter demand for oil; with more people working remotely, a lot of international travel could be considered unnecessary, and companies may bring supply chains closer to home to avert disruptions.

With oil at US$35 pb, the return on renewable projects starts to look good versus a new oilfield, which should encourage the necessary switch to renewables, going some way to address an even bigger problem than COVID-19: climate change.

Cash-strapped UK energy firms, in particular, face tough times. Thus far, they have been denied a government bailout, creating concern that some could go under or be forced to shut-in loss-making production. The UK is one of the more expensive basins arounds the world and thus will be heavily impacted by a prolonged low oil price. Saudi Arabia has low operating costs of just US$3.20 pb, which would help it in a drawn-out battle for market share; however, the country needs a substantial US$84 pb to finance its budget compared with just US$42 pb for Russia. Both sovereign states and oil and gas companies will therefore have to alter their budgets significantly if they are to survive.

As societies adapt their ways of life to cope with the virus, it is maybe a little premature to comment on how exactly COVID-19 may impact the energy production market and even more so the energy insurance industry.

However, one thing that is certain is that the oil majors will drastically cut their capital expenditure as has already been announced, resulting in significantly less drilling and construction of production infrastructure. We are also likely to see lower valuations for both assets and loss of production income (LOPI), resulting in a reduced premium base in a market that has already seen two-thirds of its income eradicated since 2014. It is also extremely likely that there will be a raft of bankruptcies in the shale arena. Bankruptcies in the shale plays jumped by 50% last year, and there are likely to be many more this year due to overleveraging. We will also likely see some consolidation in this area. Some of this will take time to come through the system as many of the shale players have hedged the oil price out to up to 12 months. These bankruptcies and consolidation will result in fewer clients and less to insure as the oil majors would run the risk for these types of operations on their own balance sheets.

Market capacity within upstream clearly has a bearing on the applicable rating environment as we have seen over recent years; however, from a broader viewpoint of the insurance sector as a whole, if the lawsuits in the US to enforce insurers to pay for Business Interruption losses regardless of pandemic exclusions succeed, we could see a paradigm shift on greater scale than we witnessed after 9/11. With the consequential industry capital depletion post 9/11 we saw a knock on effect of an average 130% rate rise in upstream energy. If these lawsuits stick, and it is a big 'if', it is possible that we will see a significant amount of capital removed from the global (re)insurance market. This could have the immediate effect of drastically reducing capacity in all lines of insurance business, with the concomitant significant rate rises that the law of supply and demand would predict.

It is also worth remembering the backdrop that is Lloyd's having made an underwriting loss for three consecutive years, which will be putting pressure for rate increases on all lines. For 2019, there was an overall profit for Lloyd's, because of the investment returns. Clearly the short-term outlook for investment returns is very bleak, which will further exacerbate the need for rate increases across the board from a carrier's management team.

Ultimately, it is too early to accurately assess the effects of COVID-19 on the upstream energy market; however, it is fair to say that facing the biggest recession in history, with some commentators suggesting a decade of economic turmoil, those effects are going to be significant.

Cedent's view:
There is an expectation that lower exposure equates to lower insurance premiums.

In the context of probable limited claims activity in marine and energy, it is the asset side of the balance sheet that will drive reviews of reinsurance structures. Limits may be affected by a re-appraisal of realistic disaster scenarios (higher cargo accumulation in ports and in storage; cruise vessels laid up en masse).

There does not yet appear to be any consensus in the market on how or what losses can be aggregated when it comes to event definitions. Composite structures are likely to be under close scrutiny as classes such as contingency, political risk and trade credit may no longer be considered to be relatively incidental. For more complex placements, including composite structures, the renewal process will need to be started much earlier.

Whilst there may be more appetite to purchase, the key question will be how badly direct premium volumes are impacted by the reduction in economic activity and oil price. So much depends on how long the global disruption lasts. When the global economy stabilises, there will still be weaker balance sheets seeking more protection, and we will be in the realms of whether it will be possible to increase rates to pay for it. Top line will still be key for many market participants.

Contractions in the supply of capacity may be largely offset by reductions in exposure and original premium volume, but an existing capacity squeeze in respect of peak energy assets or high-value storage may be exacerbated.

Where a policy is rated and has an agreed fixed premium, lower volumes going forward will generate discussion about a lower premium for future treaty periods at the next renewal. But in the short term, it is cash flow that is driving a scramble to extend premium payment terms throughout the market.

Reinsurer's view:
On the assumption there is no political pressure in respect of coverage, the claims activity will be largely derived from marine liability and peripheral classes. P&I coverage is provided on a per-vessel basis preventing the prospect of major event losses (though high-profile cases such as the Diamond Princess may have some reinsurance impact). Many P&I providers purchase aggregate or stop loss protections that are certain to be exposed to major impact. Contingency is written in the marine account in some markets, and event cancellation could be the greatest driver of losses.

Sustainability of vanilla marine and energy layers are not in doubt. More questionable is the composite structure, which may come under pressure to 'unbundle' to some extent.

From a rating perspective, the principal impact is likely to be the treatment by reinsurers of reduced original premium volumes. The need to generate underwriting margin in a world of lower investment returns will provide further momentum to a market trying to harden and adversely impact sub-classes with a longer tail.

Ongoing attempts to address the fundamental profitability of the sector (most notably through the Lloyd's Decile 10 review) already have a certain momentum. It must be assumed this will gain some additional impetus or further withdrawals are possible.

Marine and energy has long been treated as a diversifying class, but the more recent trend of focus on profitability is unlikely to change. Long-term appetite will be linked to the ability to generate adequate underwriting margin.

Reinsurers are unlikely to accept pandemic coverages into their core products. It's always possible that some markets may seek to differentiate themselves with coverage extensions, but this scenario appears unlikely at this stage.

Exclusions:
Contagious disease exclusions are under discussion with differing positions being taken across the direct market. In principle, if this is not a significant insurance loss then changes to coverage will not be required. However, insureds will have been exposed to substantial uninsured risk (ie BI, contingent or otherwise), in which case demand may increase for cover, which may not be available in the traditional insurance market.

There was initially a lack of consistency across the reinsurance market, with a number of players seeking to apply contagious disease exclusion clauses (with differing wordings ranging from purely direct to indirect losses, including general communicable disease).

Others are confident the requirement for physical loss or damage means no changes to current wordings are required, or that blanket exclusions are inappropriate (limited coverage extensions in the primary market should be covered under pro rata treaties, P&I coverages). But this appears to be more about clarification than changes to cover.

Specialty casualty

Direct market:

Risk appetite hasn't materially changed, and clients continue to reduce overall portfolio volatility through smaller gross limit deployment. Whilst this de-risking was already under way, this is likely to accelerate in the context of improving rate environment.

There is a growing awareness to the potential exposure of select casualty lines such as D&O and EPLI to claims linked to economic slowdown. Asset-value falls are also driving a reassessment of underwriting, pricing and risk appetite amongst insurers and reinsurers alike. Overall business volumes will depend in part on what steps governments take to support the macroeconomy and specific sectors; this will vary by geography and line of business, and many schemes are taking time to get up and running.

Some insurers are modestly cutting income estimates, particularly in lines that they feel may be exposed to potential losses (eg D&O) or where premium volumes may fall off naturally given the economic impact on classes such as transactional risk liability.

Clients are also keeping an eye on upcoming renewals where premium is calculated based on revenue, asset values, employee count and the like to make sure a temporary reduction in output does not translate into pricing inadequacy. This is a particular challenge in claims made lines where historic loss exposure may not correlate closely to go-forward exposure estimates. Otherwise plans have not yet changed materially, but this is under review and will evolve as the impact of the virus does.

Lloyds Syndicates, which were already operating with premium restrictions in an improving rating environment, are evaluating their renewal books and new opportunities in light of a new operating environment to ration capacity. This may result in changes in business mix versus plan.

Little or no direct claims arising from COVID-19 are anticipated, in contrast to lines such as contingency or travel; however, some are expecting increased indirect claims activity in certain sub-classes, such as:

- D&O: driven by exposure to insolvency/Securities class actions arising from economic slowdown and reduced valuations
- EPLI: concerns arising from issues such as requiring workers to continue to come to work and handling of layoffs of others
- Professional Indemnity/E&O: claims arising from falls in asset valuations (eg fund managers, independent financial advisors and investment advisors)
- Medical Malpractice/ pharmaceutical and health care: potential issues very specific to geography, provision of private or public services; focus will be on how this plays out in the US
- GL/EL: perceived as mainly a potential defence cost issue.

Rating trends in casualty classes are already maintaining the momentum generated during 2019. These are beginning to accelerate into higher price increases, reduced capacity deployment and higher attachment points.

Some carriers are looking at options to extend original policy periods for business continuity reasons. The situation is very fluid and continually under review.

Cedent's view:

COVID-19 has not significantly impacted buyers' views on structure as yet; however, it's probably still too early to tell with any certainty. Emerging claims are likely to inform views on structure and coverage requirements.

Some cedents are watching out for downgrades and their associated impacts. Irrespective of the financial security of reinsurers, there is a sentiment that capacity is likely going to retract in casualty anyway. Not necessarily as a direct consequence of COVID-19, it will be an indirect driver of market forces that are already in play. Same goes with pricing, and clients expect to see continuous pressure for price increases in the run-up to 1 June and beyond.

Clients questioning whether and how COVID-19 and related losses could be covered under clash or casualty cat covers.

Reinsurer's view:

Reinsurers do not yet know what the ultimate exposure to COVID-19 and related loss could be, but they are already looking to exclude either COVID-19 or pandemic from reinsurance treaties, whether on a blanket basis or specific to individual lines of business. There has certainly been some signalling that this will increase post the 1 April renewals where most placements were well under way before COVID-19 became viral. At the very least, reinsurers are looking for detailed commentary from cedents on their exposure to COVID-19 claims, direct or indirect, and details of how this is being addressed and mitigated going forward.

Reinsurers are looking at the evolving market dynamic as an opportunity to continue to push price increases, an agenda that started at the 1 January 2020 renewals. This hunger for reinsurance rate increases is driven by an exacerbated apprehension in taking big positions on casualty placements. Early indicators suggest that reinsurers will continue to moderate their line size and push structural changes in some instances (ie push variable QS to QS on transactional liability, shorten XOL limits where over-leveraged, or push for alignment of interest/co-participations).

Coming on top of adverse reserve deterioration and much talk of social inflation in Q4 of 2019, the emergence of COVID-19 has reinforced strict requirements to target satisfactory underwriting margin given limited supplemental investment margin or reserve cushion.

Engineering and Construction

Direct market:

At this point in time, it is considered that direct exposure arising from COVID-19 to the engineering and construction community from an insured loss perspective will generally be modest.

If the industry is forced to shut down or is adversely hit by recession, then there will be knock-on effects on:

- Insurance premium reduction if projects are shelved
- Coverage for 'mothballed' risks until construction is resumed
- Site security issues during the period that sites are closed if security is reduced
- Stock market short-term meltdown: nervous lenders resulting in less financing available now, albeit with record low interest rates; longer-term impact more severe if lockdown or recession lasts for two quarters or more

Delays to projects:

China supplies much of the construction materials to the industry, so any factory shutdown will have a knock-on effect on building costs and slower project completions due to lack of supply.

Delays to projects arising from COVID-19 (depending on the time impact of social isolation) are not necessarily immediate, and time can be made up during the project, which can be up to eight to 10 years in overall duration.

It is important to distinguish between delays to projects caused by trade risks (which the contractor will be subject to pay to the principal by means of contractually stipulated financial penalties) and those that are insurable under contractors all risks/ erection all risks (CAR/EAR) policies. Claims for delay in start-up will only be calculated at the end of project policy periods when actual delays can be identified and adjusted for.

Whilst France, Spain and Italy have experienced some suspension of construction activities, currently the UK construction market is operational.

Legal perspective:
Contractors may not have to pay for project delays caused by COVID-19, leading to contract review. If COVID-19 is declared a force majeure, this will allow works to be suspended or terminated, without penalty.

Any BI or loss of profits need to be triggered by physical damage and, unless legislation changes, COVID-19 would not be a trigger for such policies.

Cedent's view:
Insurers may capitalise on the market positioning of COVID-19 to further drive rate increases.

Any communicable disease coverage provided is expected to be reasonably modest in frequency and subject to modest sub-limits.

Reinsurer credit ratings are more of a concern than some other lines because of the medium-long-tail nature of the class.

Reinsurer's view:
Impact on estimated premium income is dependent on investor confidence in the post-COVID-19 recovery period and the impact on construction and infrastructure investment arising from a period of recession.

A modest impact to premiums is expected for the 2020 calendar year because extension requests tend to command multiplies of pro rata premium, in addition to market rate increases seen since early 2019. For the 2020 underwriting year, a 10% reduction is expected in written premium per quarter of lockdown.

Exclusions:
Many reinsurers (especially Lloyd's) were keen to incorporate LMA 5394 on their renewal line at the 1 April 2020 renewals, with some markets willing to modify this stance and remove the stipulation following provision of information from the cedent in respect of modest anticipated exposures. Where exclusions were added, some reinsurers agreed to review after six months according to known or perceived exposures identified (or not) at that juncture.

Infectious disease coverage is not prevalent in the global engineering and construction market with cover under CAR/EAR and associated delay in start-up policies being triggered by physical loss or damage. A number of extensions have been seen in the London Market. If there are extensions, they are commonly:

- Disease extension – coverage will tend to be heavily sub-limited
- Prevention of access – coverage would tend to be directly related to physical damage
- Authorities – coverage will tend to be heavily sub-limited

Cyber
Direct market:
The pandemic has created social engineering opportunities, including:

- Ransomware and phishing campaigns: attackers have often used websites that include clear references to COVID-19
- An increase in wire transfer fraud

Cyberthreat actors will take full advantage of recent high-impact vulnerabilities (recently announced vulnerabilities that targeted organisations may not have had time to fully patch). This may be even more prolific given many IT teams are working from home.

Companies will need to turn to their business continuity plans (BCPs), including security monitoring and response. Many companies have not had to exercise BCPs previously, and some smaller companies may not have a BCP.

With work-from-home policies being initiated globally, there is a shift from enterprise infrastructure to cloud and virtualized infrastructure. Employees working from home will rely on home Wi-Fi routers and virtual private network (VPN) connections to company infrastructure. Misconfigurations risk the leakage and theft of sensitive company information. Although the increased threat exists, the expectation is that there will be minimal to no impact on claims based on the market standard to exclude incidents that occurred on an unauthorized third-party computer system; however, this increased exposure may potentially create an extension of coverage for third-party computer-related losses.

The economic and operational impacts will create financial and budget challenges for companies' information security operations in the mid- to long-term, pressuring information security operations to implement tighter budgetary constraints and potentially decrease staffing.

State-sponsored hackers may be lurking in the background collecting information. There is an expectation that health care providers, vaccine developers, and government health and executive agencies will be targets of state-sponsored cyberthreat activity with potential cyberespionage.

There is a potential for failure of IT equipment within an organisation as well as issues around scaling and bandwidth constraints and slower/lack of access to platforms with an influx of companies utilising VPN providers and platforms such as Zoom, Webex and Skype.

Note, there are some areas where exposure may be lessened due to COVID-19:

- Regulatory fines due to privacy breaches are likely to be much lower given the economic pain out there (General Data Protection Regulation/California Consumer Privacy Act/Illinois Biometric Information Privacy Act and so on).
- BI claims should be much lower in the current economic environment, since most industries aren't selling anywhere near as much as they normally do. Exceptions could, of course, be online direct-to-consumer retailers, who would expect an increase of webstore traffic, and optimistic insureds with possible inadequate coverage that have experienced significant financial strain due to the pandemic, hoping to obtain coverage under their cyber policies.
- With fewer employees in the office, the usage of paper documents and printing physical documents will be lower, leading to less risk of loss or theft of physical documents.

Cedant's view:
The cyber market was already experiencing an uptick in buyers pre-pandemic, and there is potential for increased demand for cyber insurance, including new purchases, new industries and new limits. There is an optimism that companies will not cut back on cyber insurance spend even though budgets overall may be declining; however, there is an expectation that several of the known financially hard-hit industry segments (restaurants and hospitality) will submit requests for policy cancellations or payment extensions as they seek discounted coverage in the marketplace due to COVID-19.

The majority of cyber carriers focus on underwriting a diversified book of business based on size and industry segments. The view is that this diversification strategy will help to mitigate the impact of increased claims on their portfolios despite the entire market facing pressure on income with increased exposure. Despite the current environment and potential of increased exposure, the overall response in the market is that it is still too early to tell the long-term impact that COVID-19 will have on the cyber segment from a pricing, coverage and experience standpoint, and there are no immediate plans to amend underwriting guidelines or implement coverage exclusions. The shared concern is that it will be harder to conduct business in this environment, particularly with many workers working from home.

International

Property (EMEA)

Direct market:

Original policy terms and conditions differ; there is no common approach across Europe, the Middle East and Africa (EMEA).

Potential insurance exposure from COVID-19 varies significantly country by country. There isn't uniform original insurance coverage in place. Main property exposure could emanate from explicit non-damage BI coverage or extensions, particularly in the UK, France or Nordic countries, or from specific closure insurance in Germany; however, most EMEA markets require an insured property damage to trigger the BI and hence are unlikely to pay out under normal circumstances. Interference from authorities or governments with regards to coverage will also prove to be important to monitor. Given the economic downturn that the ongoing social distancing has created, some EMEA governments have started to encourage the finance industry to positively respond to claims, particularly where coverage is uncertain. Where non-damage coverage is provided, there may be restrictions and questions over damage definitions, which will lead to a lengthy process of ultimate net loss determination. Loss advices so far have often been made on a broad basis without identifying specific loss or damage.

Property treaty

Coverage provided varies between treaties and with greatest exposure likely for proportional and catastrophe contracts where certain losses may be accumulated into a single recoverable event. The key is to review the named peril exclusions and, if non-damage BI losses are covered, how the occurrence clause permits losses to be aggregated: specifically, what proximate cause is the trigger (eg government orders, WHO declarations or notification of claims) and over how long a time period and area cover exists. This will be contract-specific making it difficult to draw any generalised commentary and will test interpretations of loss occurrence definitions that are often not designed to cater for this type of outbreak; however, it is unlikely that all losses arising from COVID-19 will be allowed to be aggregated into a single occurrence for reinsurance purposes, including other lines.

Overall direct exposure to property lines is anticipated to be lower than from other lines of business. Exposure via original property policies is mainly via non-damage BI extensions, with property reinsurance treaties then offering varying levels of coverage. Key consideration is whether the BI caused by the virus is explicitly protected under the original property policy or what exclusions may apply.

In many markets, BI insurance typically requires property damage for the cover to respond. In some EMEA markets, however, such as the UK, France and certain Nordic countries, insurers do offer BI coverage without the need for physical damage as part of their 'all perils policy' or this can be purchased as a non-damage BI (NDBI) extension. Types of extension include denial of access, loss of attraction, and customers and suppliers (contingent BI).

Cedant's view:

Cedents are expecting at the renewal of their property treaties that they have to clarify their exposure to COVID-19 and other communicable diseases and/or accept an introduction of various terms and conditions enforced by reinsurers in order to manage the impacts of any COVID-19 claims on their portfolios. This would include acceptance of exclusionary language on portfolios where potential exposure is given, and the parties do not agree to specifically cover any exposure from diseases.

Reinsurer's view:

Reinsurers would at least expect to gain a greater clarity of treaty exposures to communicable diseases in order to price for the coverage and to risk manage their participations. There will likely be a push by some markets to turn catastrophe contracts that cover "all perils" back to contract coverage that operate in respect of named perils only. Other reinsurers are possibly motivated to eliminate any exposure from pandemics through exclusions, particularly in respect of the run-off of old policies.

Exclusions:

Some policies contain notifiable disease exclusions; a second set includes all respiratory-based viruses (ie family of MERS/SARS and coronavirus); a third set just excludes a subset.

If the policy operates on a named-perils basis only for non-damage BI, this wouldn't have to specifically exclude the infectious disease, as the fact that it wasn't a named covered peril would exclude it by default.

Credit and Surety

Direct market:

Lloyd's businesses are putting new credit and political risk business under greater scrutiny until they have a better understanding of the impact of COVID-19; one syndicate in particular has put new business on hold for the time being.

Export credit agencies will have a different appetite to the private market and will try to support their national exporters as much as possible, in line with the government support initiatives being given to the wider economy.

The surety market is cautious as construction projects slow down and in some cases stop entirely. Underwriters will be paying particular attention to the balance sheet strength of their clients and their ability to endure a prolonged economic hibernation.

Although major credit insurers are trying to support their policyholders, the situation will undoubtedly change their risk appetite with particular impact in the following sectors:

- Aviation
- Shipping
- Travel and leisure
- Metals and mining
- Retail and other consumer cyclical businesses
- Automotive industry and other supply chain dependent sectors
- Oil and gas: there is concern around the implications of the collapse in the oil price for countries dependent on income from it.

Although no spike has been seen in claims yet, the prognosis is not encouraging. In the trade credit class, we would expect to see claims coming through over the next few months, although the various government initiatives being put in place to support the market will hopefully moderate the impact.

Cedent's view:

Reinsurance structures have been typically modelled to one-in-200-year scenarios, taking into account the impact the global financial crisis of 2008 had on the business. A pandemic such as this, with the global economy effectively being put into lockdown, has not been seen before, so there is a degree of concern as to how this will ultimately impact the business and whether the net retentions are correct.

There is no concern over recovery prospects as underlying policies and reinsurance treaties do not exclude pandemics.

Reinsurer's view:

Reinsurers are nervous about the impact on claims. The view is not positive as more companies become distressed, supply chains break down and payment defaults occur.

Reinsurers learned lessons from the 2008 global financial crisis, and the expectation is for them to remain supportive, although markets will be under considerable scrutiny from senior management due to the correlation with the equity markets.

Credit reinsurance markets have experienced many difficult events over the years, and at this stage we don't feel there is too much concern over the longevity of the product, although new business may be problematic.

There is a possibility that certain reinsurers may view other lines as more attractive and move capital out of the line of business. Volatility in equity markets resulting in mark-to-market capital position changes, not helping this position.

Exclusions:

Original policies are not expected to introduce exclusions for pandemic, but underwriters are expected to navigate particular sectors more carefully. Reinsurance treaties are back-to-back with the original policies in this regard.

Casualty

Direct market:

For most clients offering long-tail liability coverage, the overall impact of COVID-19 on the line of business is a little early to tell. It is likely that information will be provided to shareholders (for listed companies), regulators (for insurers) and to members (for mutuals), and this information will be responding to questions of products exposed and potential claims exposure.

Anecdotally, there is some evidence in the Australian press that suggests a reduction in enquiries and an increase in cancellation of policies following governmental shutdown of nonessential services. This is now something being monitored by the Insurance Council of Australia. Carriers writing SME business have also noted a reduction in enquiries; some have cancelled writing new BI, with no real impact on GL lines at the current time. Most carriers in Australia and New Zealand have also announced measures to support their customers through these challenging times, including:

- Travel insurance refunds for any unused proportion of premiums, including full refunds where customers have not yet travelled and have not claimed under their policy, with no administration or cancellation fees.
- Deferred premium payments for up to six months for small businesses that are experiencing financial hardships.
- Refunds on the unused proportion of premiums for small businesses that cancel their insurance, with no administration or cancellation fees.

There has been more dialogue with respect to personal accident, particularly in Asian markets. Japanese clients have specific coverage for pandemic as it is sold as part of their travel policies and can also be purchased as an endorsement to an ordinary personal accident (PA) product. For that reason, Japanese insurers should be able to produce an estimate of their pandemic exposures (Probable Maximum Loss) with relative ease, and these figures would be equally applicable to COVID-19.

There is a mixture of issues here that will include whether governments will insist on insurers paying claims and whether the standard of care is altered given public policy considerations. Some regulators, such as the Australian Prudential Regulation Authority (APRA), have requested that banks and insurers consider deferring decisions on dividend payouts or using buffers such as dividend reinvestment plans until the outlook is clearer due to the COVID-19.

There will be issues with mental health and the potential for claims arising from a wider group of claimants:

- Ongoing unemployment and recessionary forces will have an impact on claims culture; there is the potential for more people to make claims at this time whether it is for bodily injury or wrongful dismissal.
- Strict liability for workers' compensation or employers' liability could be a problem: it seems to be the case that people are either recovering or dying and therefore requiring little ongoing care, which should mitigate claims activity.
- Professional lines claim activity will vary depending on to what degree people are considered to have been negligent. At the current time, there is not a clear picture emerging for this sub-sector.
- There is no doubt that there could be some D&O claims given some of the issues around disclosure and whether standards are appropriate or satisfactory given public policy considerations.

Cedent's view:

Whilst highly uncertain, it is likely that gross premium projections for 2020 calendar-year business will be overstated. The same applied for business on a financial-year basis for 2019/2020, and estimations for financial-year 2020/2021 will be challenging. It is therefore likely to give rise to requests for reduced minimum and deposit premiums in reinsurance contracts.

There is concern about back-to-back coverage and the blanket introduction of a COVID-19 exclusion. Most clients do not want to have a reinsurance exclusion and are anxious that they will not have the time to pass any restrictions onto their clients.

It is unclear how this loss event will impact the purchasing appetite post-pandemic, but it is likely to increase the recent trend of insurers purchasing more. Some markets (eg Japan) have just finalised their renewals and will need to deal with these questions later.

Some questions already about the credit worthiness of reinsurers have been asked. There is board and regulatory interest in some jurisdictions in relation to counterparty security and reinsurer selection.

At this stage, it doesn't appear that there will be a withdrawal of capacity, but there is an increasing view that capacity could contract, terms could tighten and pricing will increase. Clients with 1 April 2020 renewals were keen to finalise placements before exclusions could be included.

The scope of event coverage for COVID-19 claims in casualty remains unclear.

Reinsurer's view:
Most reinsurers are seeking clarity from their cedents about potential exposure, while some have sought to add exclusions to treaty wordings. Others are walking away from PA business due to potential exposure and lack of exclusions. It is too early to tell if there is an impact on pricing, with the mid-year renewals more likely to be a test of this. But where there is clearly exposure to pandemic, pricing will surely come under review.

Capacity is still plentiful for the time being, which gives cedents some power in negotiations relating to the inclusion of COVID-19 exclusions. For a number of reinsurers of casualty business, we have, however, seen some restraint with the addition of specific COVID-19 exclusions if they are able to work with the cedent to understand the actual exposure presented by different classes of business offered.

At this stage, there is no real concern around sustainability of reinsurance products; however, reinsurers will continue to monitor the claims environment.

Approach to quantifying exposures and defining action plans could become a selection mechanism for reinsurers.

Reduction in value of investments could have significant impact on cost of capital and resulting implied underwriting margin.

Exclusions:
It is anticipated that exclusions will be proffered by some reinsurers for COVID-19 or broader infectious disease exclusions depending on the class of business.

Some reinsurers are taking the more pragmatic approach of seeking to work with clients to understand what the likely and potential exposure might be.

Property (Asia Pacific)

Direct market:
There is limited impact on business plans for domestic insureds but perhaps a greater concern for those targeting multi-nationals or particular industry segments. These are still early days so the full impact is unknown, but many insurers still seem to expect a relatively swift return to normalcy. China, for example, is already sounding much more upbeat.

Cedent's view:
We do not anticipate significant recovery or coverage issues on the property side, but that is pending any government/regulatory intervention; policy triggers are well specified in Japanese contracts.

There is little change to the apparent creditworthiness of reinsurers; losses (covered or not) always heighten the perceived value of reinsurance. Earnings protection is still expected to dominate, which might create some demand versus historical performance stress if reinsurance capacity is either withdrawn or repriced.

There is suspicion that coverage restrictions will be enjoined with any pricing movement.

Reinsurer's view:
Only a minority of reinsurers have thus far raised the question of exposure to COVID-19-related claims with cedents.

Coverage available in Asia Pacific is generally back-to-back with original policy wordings, so any possibility of a gap in cover is perceived to be small.

Exclusions:
A number of territories in Asia already carry exclusionary language on property covers as a result of their encounters with SARS and various types of bird flu.

The Japan renewal has just closed and there were various attempts by markets to impose broad exclusions. Most clients seem comfortable with the coverage they secured, with some managing to mitigate the situation by pointing to the exclusions on original policies. For 1 April renewals closed out before the third week in March, the majority of placements were complete without exclusions, although some reinsurers insisted on confirmation that they were not walking straight into a COVID-19 loss. After that, most reinsurers were imposing full ID exclusions.

Appendix

Appendix I: US property legal landscape

New Jersey Bill

The state of New Jersey introduced a bill to retrospectively impose coverage for losses due to pandemic on certain BI policies. The bill would apply to policyholders with fewer than 100 eligible employees in the state of New Jersey. The Reinsurance Association of America (RAA) is reporting that New Jersey did not vote on this, as scheduled, since they were waiting on a federal update. There is a possibility that New York, Massachusetts, Ohio, Pennsylvania, Illinois, California and South Carolina are all following.

There is hope that the fiscal stimulus package will reduce pressure to move towards retroactive coverage bills.

Court cases: "Is COVID-19 a direct physical loss"/"all risk"

- Chicksaw Nation (Oklahoma) – Casino
- Oceana Grille (Louisiana) – Restaurant
- Thomas Keller Restaurant Group - Claims that COVID-19 has physically impacted "public and private property, and physical spaces in cities around the world and in the United States."

Insureds are arguing that physical damage would apply to an electrical blackout, and there is precedent for this example.

Cases have ruled in favour of the insured in New Jersey:

- *Wakefern Food vs. Liberty mutual;*
- *Gregory Packaging vs. Travelers;*

Cases have ruled in favour of the insurance company:

- *Ferraro vs. North Country Insurance;*
- *American Guarantee vs. Ingram Micro;*

Federal Intervention

Various approaches reported by the RAA today include:

- Insurers to serve as an administrative vehicle to disburse funds to businesses often with a modification in BI coverage for viruses
- Create a Terrorism Risk Insurance Program-like mechanism and/or seek industry's voluntary coverage under BI for the current virus

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Appendix III: Regulatory and rating agency response

European Insurance and Occupational Pensions Authority (EIOPA)

https://www.eiopa.europa.eu/content/eiopa-statement-actions-mitigate-impact-coronavirusCovid-19-eu-insurance-sector_en

https://www.eiopa.europa.eu/sites/default/files/publications/eiopa-recomendation-on-reporting-and-disclosure.pdf

US Department of Health and Human Services: Public Health Emergency: PREP Act Q&As:

https://www.phe.gov/Preparedness/legal/prepact/Pages/prepqa.aspx

Covid-19 Outbreak: AM Best Analysis and Commentary

http://www.ambest.com/about/coronavirus.html

S&P Global: Coronavirus Coverage

https://www.spglobal.com/en/research-insights/topics/coronavirus

Fitch Ratings: Coronavirus Homepage

https://www.fitchratings.com/topics/coronavirus

Moody's: Coronavirus Effects

https://www.moodys.com/newsandevents/topics/Coronavirus-Effects-007054?cid=K5OTAK0BP4470

Appendix IV: External sources

Capital IQ and Willis Re

www.macrotrends.net

James Davey British Insurance Law Association - Coronavirus - insurance, frustration and frustrated customers

Riley on Business Interruption Insurance

Concirrus

Insurance Day

Appendix V: Further reading

Covid-19 (Coronavirus) on the WTW website (updated daily):

https://www.willistowerswatson.com/en-GB/Insights/trending-topics/covid-19-coronavirus

Includes articles, webinars, WTW experts, WTW resources and links to government and third-party resources to assist you through this unprecedented and rapidly changing event.

Covid-19 (coronavirus): An actuary's perspective (Life):

https://www.willistowerswatson.com/en-GB/Insights/2020/03/Covid-19-coronavirus-an-actuarys-perspective

Insurer Insights: Covid-19 (coronavirus): a new operational reality for life insurers

https://www.willistowerswatson.com/en-GB/Insights/2020/03/Covid-19-impacts-life-insurers-on-several-fronts

Strategic pandemic stress scenario tests: Not just for health insurers

https://www.willistowerswatson.com/en-GB/Insights/2019/09/strategic-pandemic-stress-scenario-tests-not-just-for-health-insurers

Workforce Principles for the Covid-19 Pandemic: Stakeholder Capitalism in a Time of Crisis

https://www.weforum.org/whitepapers/workforce-principles-for-the-covid-19-pandemic/

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