INSURANCE INFORMATION INSTITUTE

Triple-I Update Economic Briefing

Covid-19 Impact on PC Insurance Market: Business Interruption and Pandemics

Thursday, April 16, 2020

Dr. Steven Weisbart, Senior Vice President and Chief Economist ♦ Dr. Michel Leonard, CBE, Vice President and Senior Economist
Insurance Information Institute ♦ 110 William Street ♦ New York, NY 10038
stevenw@iii.org ♦ michell@iii.org ♦ www.iii.org

Triple-I Actively Supporting Members and the Industry

- Do not hesitate to reach out to Michael Barry, Head of Media and Public Affairs (michaelb@iii.org) or Sean Kevelighan, Chief Executive Officer (seank@iii.org).

Economic Summary

US GDP likely to have contracted by as much as 40% in March. Year-to-date, this is the equivalent of a decrease of about 7% for the year

Insurance industry will experience decrease in profit, earnings, and returns on investments. Insurers doing their part to support economy including through voluntary refund and rebate for customers worth well over 10B collectively year-to-date

Claims will raise across most lines. Impact across lines can be summarized as follows:

- High Impact: Workers Compensation, Health
- Moderate Impact: Life, Liability, and D&O
- Low Impact: Property, Auto

Economy unlikely to start recovering until Q4 of 2020 followed by slow growth in 2021

Insurance News

INSURANCE INFORMATION INSTITUTE

For immediate release

New York Press Office: (917) 923-8245; media@iii.org

Triple-I: U.S. Auto Insurers to Return $10.5 Billion to Customers

NEW YORK, April 11, 2020—U.S. auto insurers will return more than $10 billion to their customers nationwide, according to an estimate released today by the Insurance Information Institute (Triple-I).

“Insurers are again fulfilling their role as economic first responders by providing financial relief to customers when they need it most,” said Sean Kevelighan, CEO, Triple-I. “If the rest of the nation’s private-passenger auto insurers are as generous as the companies the Triple-I knows about, we project insurers will be giving customer refunds, discounts, dividends, and credits totaling $10.5 billion.”

The Triple-I’s $10.5 billion estimate is based on its analysis of 14 U.S. auto insurers who announced this week premium refunds, discounts, dividends, and credits totaling $8.1 billion. These insurers cited reduced policyholder mileage and the receipt of fewer claims amid the COVID-19 crisis as the reasons they were able to make these decisions.

Given there are hundreds of companies that sell private-passenger auto insurance in the U.S., the Triple-I looked at the industry’s cumulative market share and estimated an additional $2.4 billion in refunds, discounts, dividends and credits were forthcoming. The Triple-I has updated its Fact Sheet, Insurers Offer Forward-Looking Solutions For COVID-19 Recovery, to reflect the latest steps taken by the nation’s auto insurers.

“These are challenging financial times for millions of Americans, and the country’s auto insurers are making it easier for their customers to get through this extraordinary time in U.S. history,” Kevelighan stated.

The Triple-I estimates the typical U.S. auto insurance customer spent $1,113 in 2019 to cover a single private-passenger vehicle.

Understanding Insurance Surplus

P/C Industry Capacity: What Is Surplus?

- The industry prices coverage for expected claims, with surplus for unexpected claims, such as exceptionally severe hurricanes

- By law and regulation, each insurer maintains an amount of “surplus” for use when claims and/or other expenses exceed allowances in premiums
  - The surplus backs up each line of insurance that each company writes
  - It is calculated as assets minus liabilities and rises and falls due to changes in asset values and claims
  - Drops in stock market valuations lower assets and surplus
  - Regulators set minimum levels and rating agencies downgrade insurers whose surplus levels fall too far

Risk Based Capital

State regulators use Risk-Based Capital (RBC) to indicate when a company has insufficient capital and surplus to operate safely

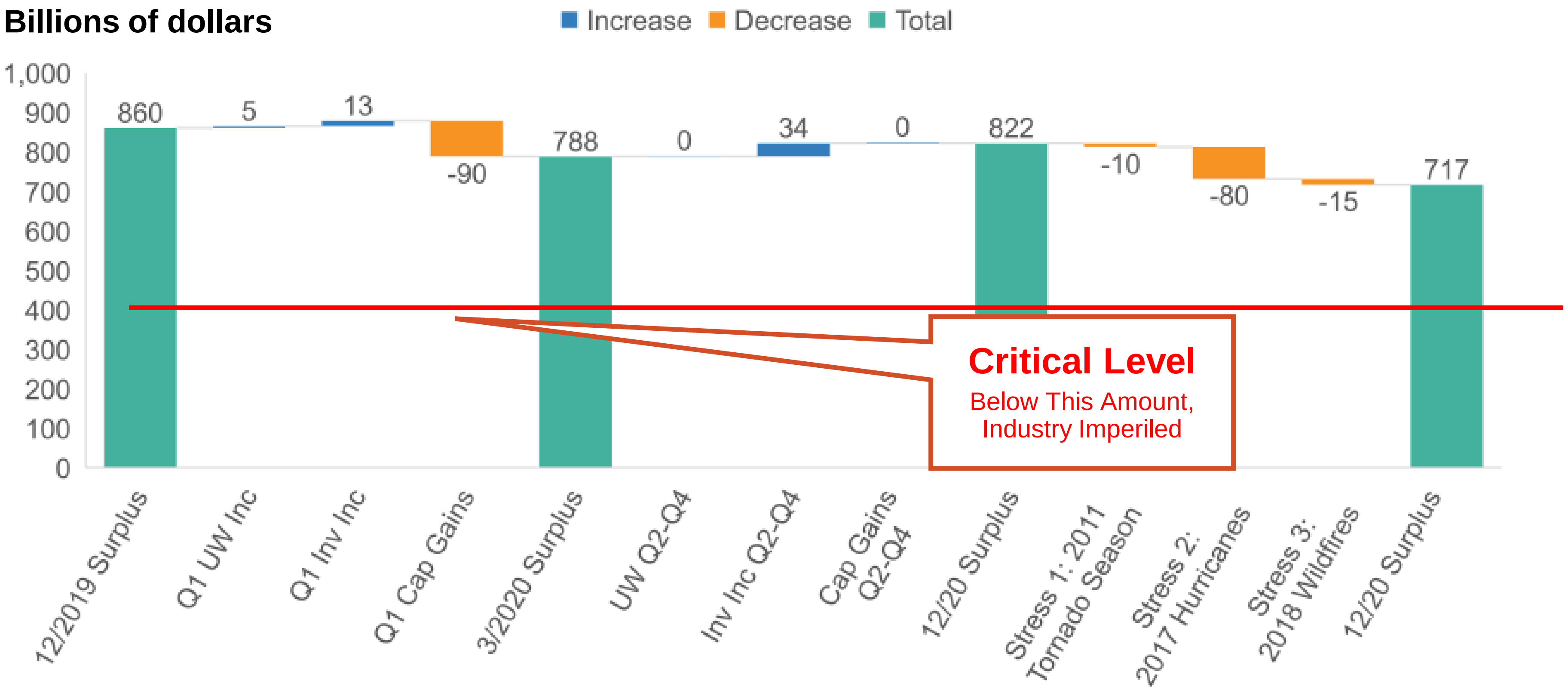
- The RBC calculation covers several types of risks that are inherent in providing insurance:
  - Asset risk
  - Credit risk
  - Loss reserve risk
  - Premium and growth risk

The “Company Action Level” of RBC ratios is the level at which companies must report to regulators how they will raise their financial status to a safe level. For the industry as a whole, this is roughly $400 billion.

Source: NAIC, via S&P Global; Triple-I

Surplus Available for Unexpected Losses

After assumptions (at right), surplus available for unexpected losses is $317 billion.

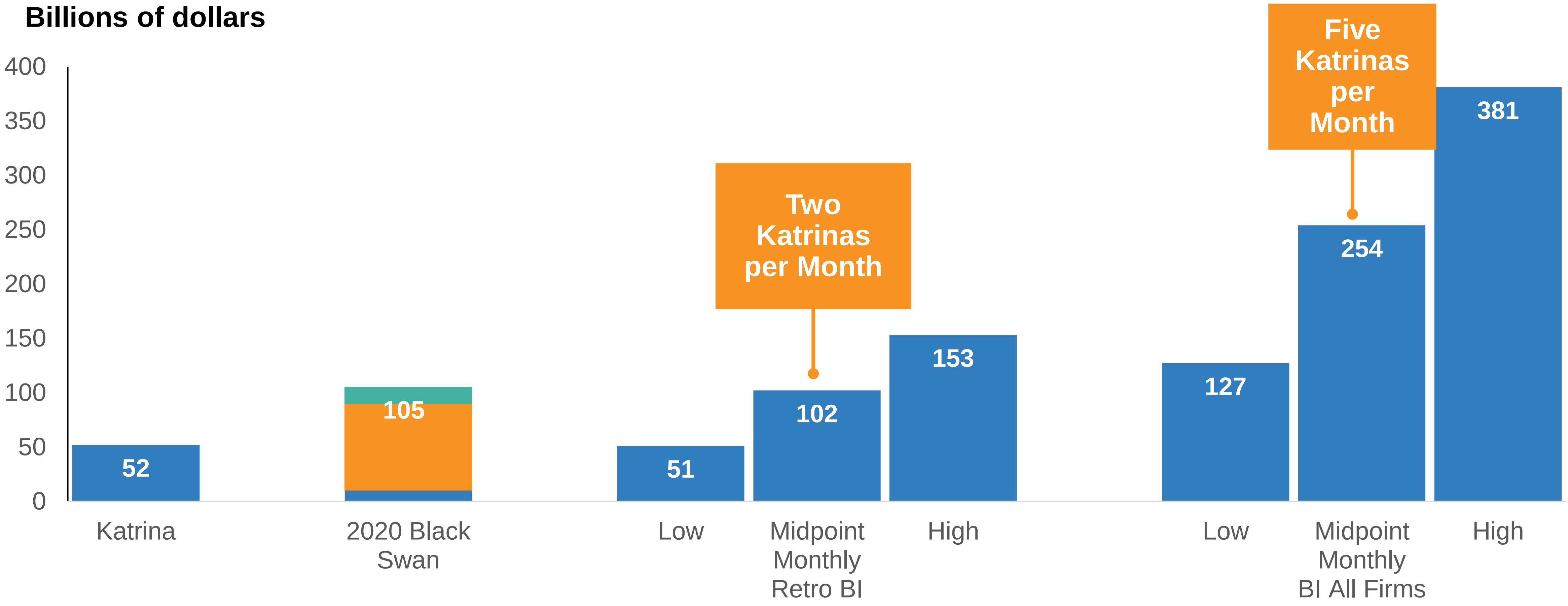


- Q1 capital loss is Triple-I estimate
- Q2 capital gains/ losses assumed to be $0
- Q2-Q3 assumes worst year of catastrophe claims above trend
- Q2-Q4 U/W profits assumed to be $0

Sources: NAIC data sourced from S&P Global Market Intelligence; Insurance Information Institute.

Retroactive BI threatens other insurer promises

Loss estimates dwarf other black swan scenarios



Source: Insurance Information Institute.

Can the P/C Industry Insure Losses Caused by a Pandemic?

- No, not in policies widely available. Insurance works only if insurers can be confident that losses can be
  - Priced so that many independently-exposed units would buy the coverage, and
  - Total claims can, at most, be kept within limits of available capital.
- Few businesses have bought this coverage, probably because the price is judged too high for the protection offered.
- The policies that have been bought, like the one by the All England Lawn Tennis Association (which runs the Wimbledon tennis tournament) were uniquely negotiated. And claim payment was prompt.

Business Interruption

Implications of retroactive and expanded coverage

What is business interruption (BI) insurance?

- Option added to property, businessowners or commercial multiperil policies
- Typically covers
  - Profits
  - Payroll
  - Other expenses (rent)
- Triggered by
  - Suspension of operations
  - Direct physical loss or damage
  - Covered cause of loss
  - Virus *specifically* excluded

Sources: American Property Casualty Insurance Association, Insurance Information Institute; Getty Images.

Key Modeling Assumptions

Two BI scenarios and losses expressed on peak month and adjusted yearly basis

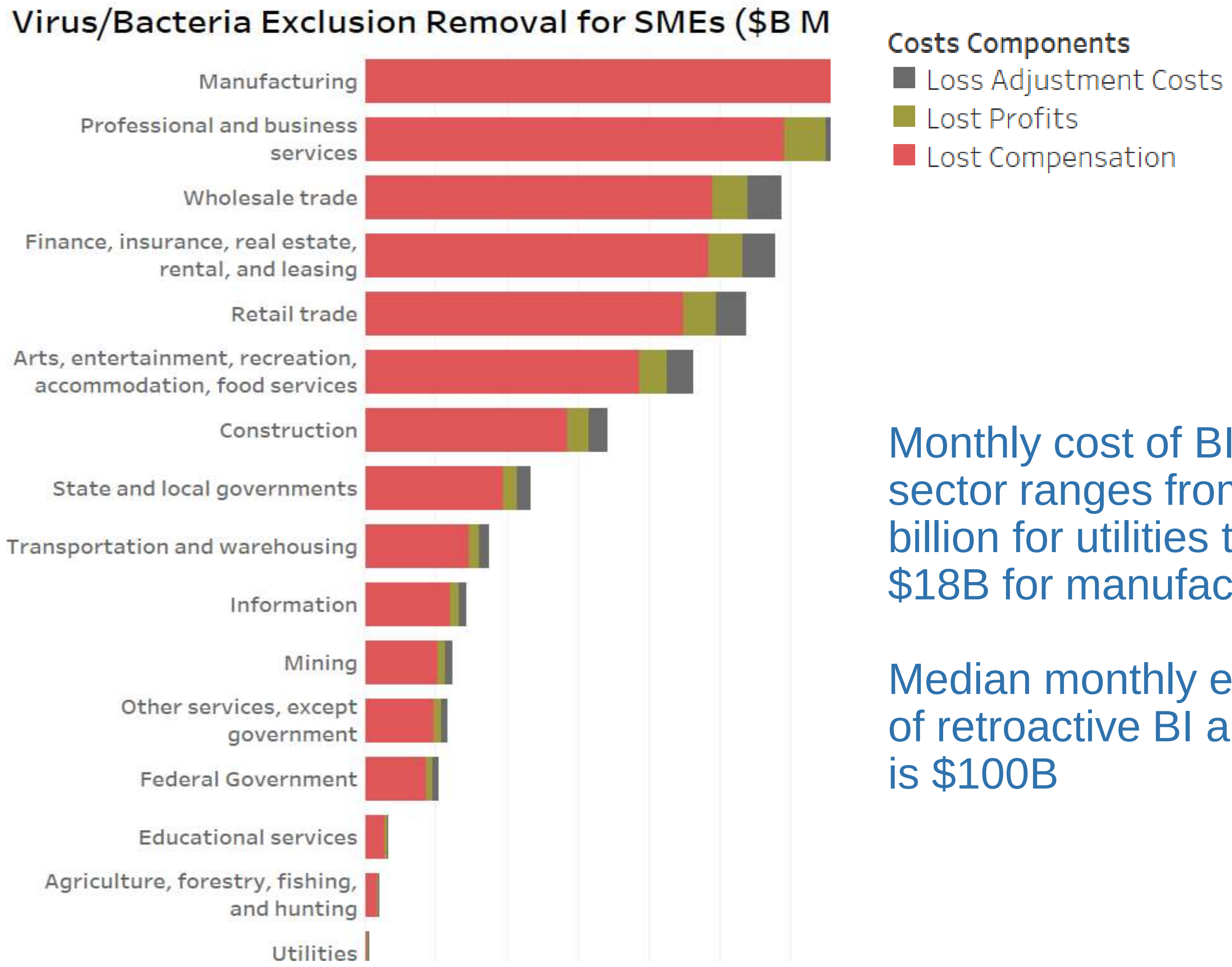
Macroeconomic Level

- US GDP of $22T with SMEs representing 43.5% of this number
- At peak business closures:
  - 95% of businesses under some sort of business interruption
  - Average lost output across industries is 47%
  - Monthly loss to US economy as high as $700B and to SMEs $340B
- Latest GDP estimates for 2020 point to yearly decrease between 4% and 6%

Policy Level

- BI coverage for SME companies
- Key loss and cost basis:
  - Lost compensation (est. 70% of revenues)
  - Lost profits (est. 7% of revenues)
  - Adjustment costs (est. 10% of insured loss)
- T&C include 7 days waiting period and retained loss of 10% of total loss
- Take-up rate of 40% for scenario one and 100% for scenario two

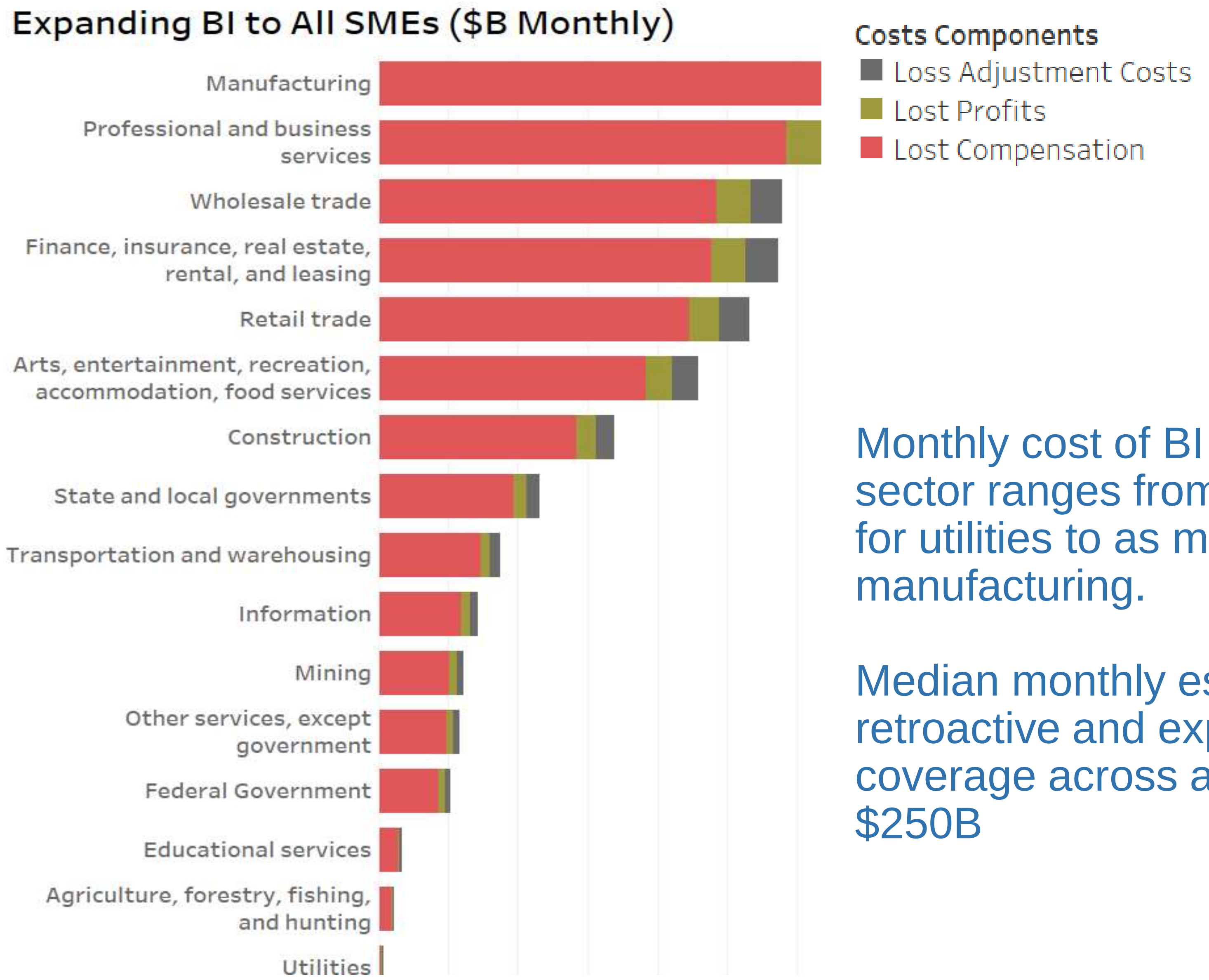
Virus/Bacteria Exclusion Removal



Monthly cost of BI coverage by sector ranges from roughly a billion for utilities to as much as $18B for manufacturing.

Median monthly estimate for cost of retroactive BI across all sectors is $100B

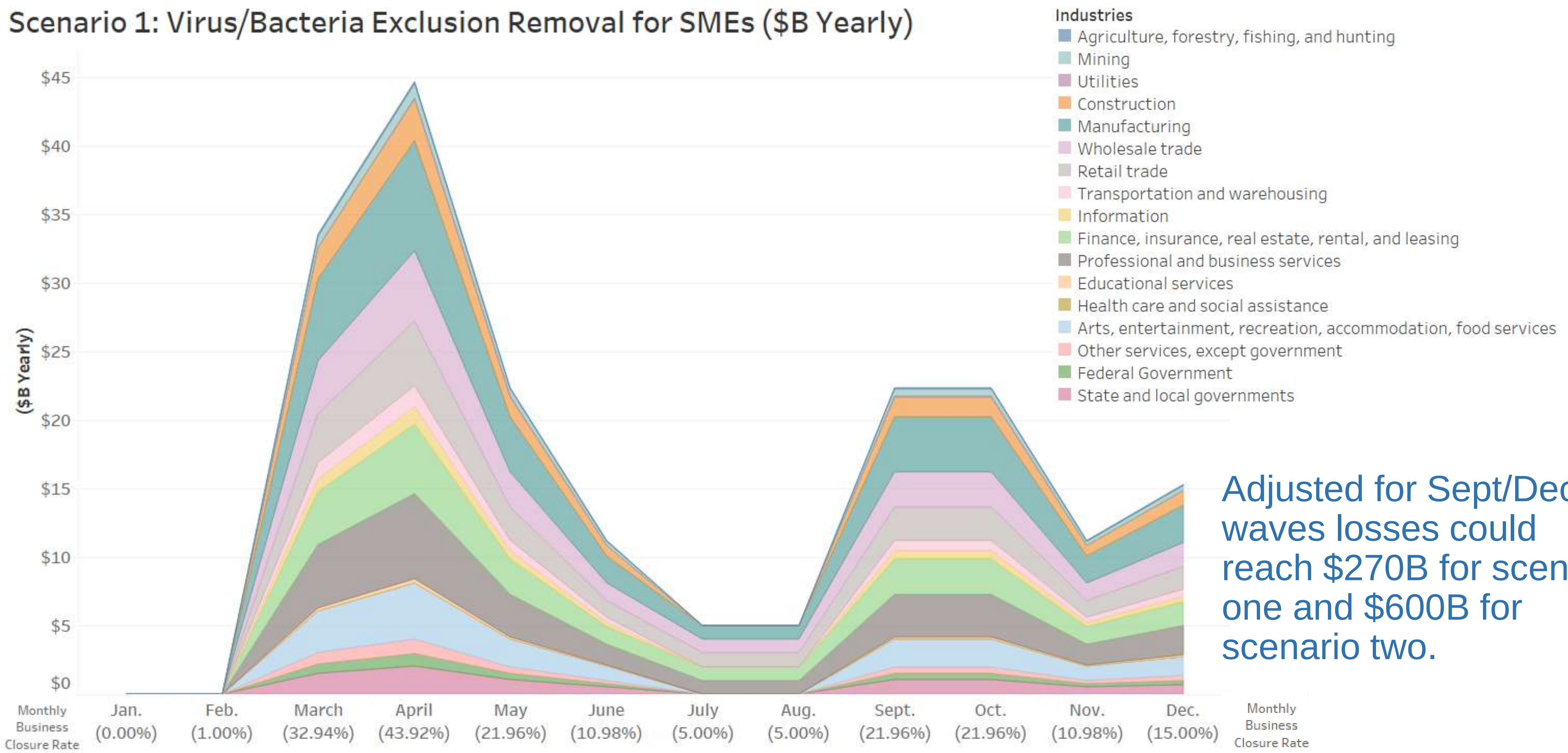
Expanding BI to All SMEs



Monthly cost of BI coverage by sector ranges from roughly $4B for utilities to as much as $46B for manufacturing.

Median monthly estimate for retroactive and expanded BI coverage across all sectors is $250B

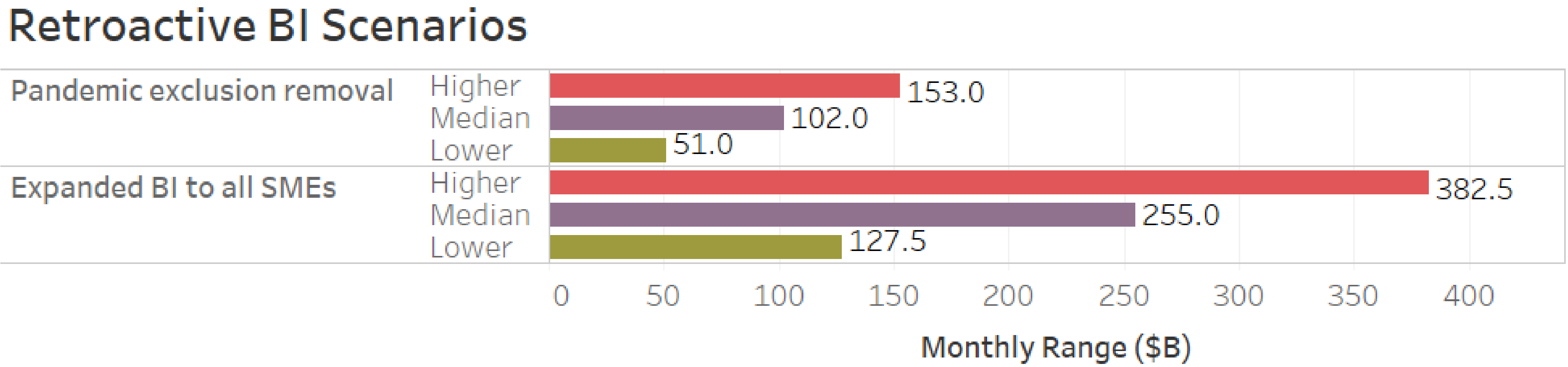
BI Losses Due to Covid-19 2020 Full Year Forecast



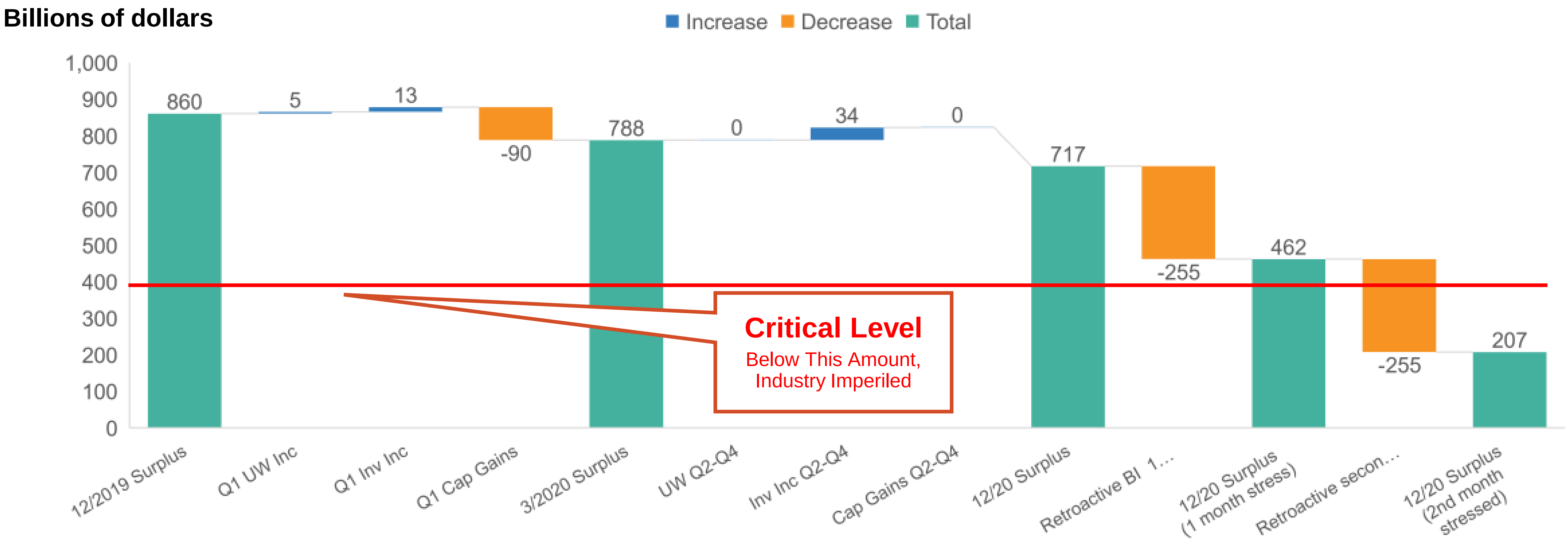
Adjusted for Sept/Dec waves losses could reach $270B for scenario one and $600B for scenario two.

Covid-19 Business Interruption Impact Scenarios

Retroactive changes could cost industry from roughly ~$150B to nearly as high as ~$380B



Effect on Surplus of Pandemic-Related BI Losses



Sources: NAIC data sourced from S&P Global Market Intelligence; American Property Casualty Insurance Association; Insurance Information Institute.

Conclusion

- Severe economic drop as high as 40% of GDP for March and 8% of GDP for year
- For insurance, highest impact will be on health, workers comp, and liability/D&O
- The property/casualty industry has enough surplus to keep its promises to customers
- Retroactive BI could cost industry from roughly $150B to nearly as high as $400B
  - Threatens insurance industry’s ability to meet contractual obligations
  - Would likely eliminate business interruption on all policies

Dr. Steven Weisbart
stevenw@iii.org

Informed. Empowered.

Dr. Michel Leonard, CBE
michell@iii.org