

ADDRESSING THE PROTECTION GAP FOR PANDEMIC RISK: FINDING A WAY FORWARD

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Please cite this publication as:

OECD (2021), *Addressing the Protection Gap for Pandemic Risk: Finding a Way Forward*,
<https://www.oecd.org/finance/insurance/addressing-protection-gap-pandemic-risk.htm>

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KEY TAKEAWAYS

- The necessary public health measures to contain the spread of COVID-19 have had devastating impacts for many businesses around the world that have been forced to curtail their activities and/or adapt to changing consumer preferences.
- The magnitude of simultaneous losses around the globe and the complexity of predicting government containment decisions and changes in consumer behaviour make this risk impossible for the insurance and reinsurance sector to assume alone. As a result, insurers and reinsurers are ensuring that exclusions of pandemic risk are unambiguous in future contracts across several lines of business with implications for the recovery of many sectors that depend on such coverage.
- (Re)insurers and brokers around the world have developed pandemic insurance frameworks and are engaging in discussions about the structure of a potential public-private partnership program for future events. The proposals rely on significant government support, but acknowledge a role for the insurance sector and insurance buyers.
- A public-private solution for pandemic risk involving the insurance sector could offer many benefits over government crisis loans and grants, including in terms of efficiency and fairness as well as incentives for risk reduction. It would also provide businesses with predictability about their access to funding in the event of a future pandemic. Capital markets could provide a source of additional funding capacity through the insurance-linked securities market, which has experience assuming pandemic risk.
- The lessons from COVID-19, from the need for improvements in public health and business preparedness to the availability of new data on mitigation measures and business impacts, provide an opportunity to reduce future pandemic impacts and enhance insurability. The involvement of the insurance and reinsurance sector in distributing coverage and assuming risk would contribute to building future resilience.
- It is likely that infectious disease outbreaks and pandemics will become more frequent as a result of a number of social, environmental and economic factors. Once the current crisis subsides, governments, insurers and businesses need to be ready to find a viable solution to providing financial protection for a risk that may materialise much sooner than anyone hopes or imagines.

FORWARD AGENDA



In order to reduce the likelihood that future infectious disease outbreaks will evolve into global pandemics or spread more widely, a variety of interventions to improve public health surveillance are needed. **Greater coordination and information sharing on how to better address a pandemic, and the establishment of protocols, would be key components in limiting the impacts of – and uncertainty around – a potential or actual pandemic.**



Greater investment needs to be made into the **modelling of the financial consequences of infectious disease outbreaks** in order to build the level of confidence necessary for the use of modelling in risk transfer decisions. As COVID-19 outcomes address substantial data needs, the insurance sector can contribute to building modelling capacity. Governments will also have a key role as end-users when considering public health sector investments.



The insurance sector needs to invest in improving the availability of innovative products to respond to the emerging risks faced by its customers while ensuring it has the capacity and knowledge necessary to manage the risks it assumes. It also needs to continue to provide clarity on the scope of the coverage included in the products that are distributed, including whether those products cover specific perils such as pandemics or infectious disease outbreaks. Traditional approaches that limit business interruption coverage to events that cause physical damage may not be fit for a future where increasing value rests in businesses' intangible assets.



Governments need to be more strategic in managing the contingent liabilities that they face for risks that are broadly uninsured. In countries with broad social safety nets, uninsured losses will often result in demands for government support that will not always be met efficiently or fairly. In countries with more limited social safety nets, uninsured crises risk creating even greater hardship for the most vulnerable parts of society.



The insurance sector and governments need to actively engage and discuss how best to address the potential contingent liabilities from pandemic risk so that lessons learned can be applied that ensure better management of the next crisis.

INTRODUCTION

The COVID-19 pandemic has devastated our societies and economies, claiming more than 3 million lives to date and reversing much of the economic progress made since the 2008 financial crisis. Today, over 45 million workers are unemployed across the OECD and 2020's global GDP is estimated to have fallen by nearly 3.5% – equivalent to around USD 6 trillion in relative lost output. Global growth is projected to average nearly 5% per annum over 2021-2022, but output in many countries is expected to remain below pre-COVID projections in late 2022, especially in fast-growing developing countries like India and Indonesia. According to the World Bank, more than 100 million people have been thrust back into extreme poverty and the number of people facing food insecurity has more than doubled. Three decades of progress in poverty reduction has been lost.

Governments in OECD countries offered unprecedented financial support to businesses and their employees through wage subsidies, tax deferrals and guarantees. While this support mitigated the economic impacts of COVID-19, it has come at a heavy cost to public finances. Debt-to-GDP ratios in OECD countries will be approximately 20% higher at the end of 2022 than they were in 2019. In many economies, government debt as a share of GDP will reach its highest level in decades.

“Each month of strict confinement has resulted in approximately USD 1.7 trillion in lost revenues across OECD countries with severe impacts on the accommodation, food, arts, entertainment and recreation sectors.”



Angel Gurría,
Secretary-General
OECD

“The last year has demonstrated that traditional insurance solutions cannot fully provide businesses with the protection that they need against the enormous cost of a pandemic.”



Flavio Piccolomini,
President, Marsh
International

“There can't be a situation where there is a mismatch between expectation and reality. We have to learn the lessons from this pandemic – customers need to have certainty of whether they have or haven't got cover. This will be a defining issue of the future of our industry.”



John Neal,
CEO, Lloyd's

IMPACT ON BUSINESSES

Businesses around the world have been broadly impacted by COVID-19. Many sectors have faced significant declines in revenue and employment as a result of both government-imposed restrictions and changes in consumer demand and behaviour. Some sectors have been more severely impacted than others. In the travel sector, for example, one estimate predicted that close to 50% of travel-related jobs would be lost by December 2020. In the United Kingdom, 50,000 people became unemployed in the film and television production sector due to the challenges of complying with social distancing requirements. Globally, the film, television and streaming sector could face USD 160 billion in lost growth. In the live music industry, revenue declined close to 85% in 2020 in the United Kingdom with the event calendar for most of 2020 and the first half of 2021 entirely wiped out.

All sectors have had to adapt to new ways of working in order to protect their employees and customers and maintain access to essential goods in the face of important supply chain disruptions. Some companies took innovative approaches to supporting employees and suppliers. Grupo Exito, for example, supported suppliers facing liquidity challenges (particularly small companies) by providing immediate payment in order to ensure the availability of working capital, and supported employees by creating new assignments for those facing unemployment with a charitable initiative that provided food baskets to those in need. Many companies implemented new protocols to ensure the safety of employees and provide confidence to their customers. In the travel sector, for example, high cleaning standards and the use of new sales channels allowed the industry to achieve above average occupancy rates once travel restrictions were lifted. In the film and television production sector, an entirely new set of health and safety protocols had to be developed and implemented to restart production.

Different types of insurance coverage provided different levels of support to businesses through the crisis. Life and health insurance, and workers' compensation, responded well to the needs of employees and their families where affected by COVID-19. Most insurance contracts covering business interruption losses did not cover the pandemic-related losses incurred. The majority of businesses found that their business interruption coverage required physical damage to be applicable, while non-damage business interruption policies, when available, often applied virus exclusions. For example, for Grupo Exito, there was no coverage available for lost revenues from leasing to commercial tenants that were no longer able to pay their rent in the context of widespread closures of non-essential retail stores. In some cases, there was ambiguity and/or differing interpretations of policy wordings and definitions that have led to many disputes and litigation. In some countries, such as South Africa, some certainty has been provided through court judgements – and insurance companies have committed to processing claims in those cases. As of May 2021, the insurance sector has reported USD 36.7 billion in insured losses as a result of COVID-19.

While there were a few specific insurance products available to protect against business interruption losses resulting from infectious disease outbreaks (including pandemics), there was limited take-up of such coverage – even among businesses that had experience with the consequences of past epidemics such as Ebola, SARS and MERS.

CHALLENGES TO INSURABILITY

A global pandemic is inherently challenging – if not impossible – to insure on a broad level in private markets. There is limited understanding of the frequency and potential severity of infectious disease outbreaks as a result of limited historical experience, a potential for enormous losses to businesses in the context of government restrictions and changing consumer behaviour and the possibility of near-perfect correlation if businesses in every sector and every region of the world are affected simultaneously (eliminating any possibility of risk diversification).

Pandemics and epidemics occur as a result of a zoonotic spillover of a novel virus or a mutation of a known pathogen introduced into a previously unaffected population with limited established immunity. While the risk of an outbreak is known, it is extremely difficult to predict when such an outbreak might occur. There is some evidence that the frequency of infectious disease outbreaks is increasing as a result of a changing climate, increased mobility and more frequent exposure to animal life through deforestation, informal mining and other human encroachments on wildlife habitat. The World Health Organization has received, on average, over sixty notifications of potential health emergencies every month (2018-2020) of which 370 were identified as events to monitor.

While the uncertainty in frequency and severity is a challenge for insurers and reinsurers, the main risk is the potential for accumulated losses. Insurance is based on the premise that a small amount of premiums collected from the many are sufficient to pay the claims of the few in a given year. With some estimates suggesting production losses of USD 4.5 trillion as a result of the COVID-19 crisis, the limited amount of premium collected globally to cover business interruption losses is clearly insufficient. Due to the potential for accumulation, business interruption losses resulting from a global pandemic are geometric, not arithmetic.

As much of the economic impact is driven by government approaches to containment, there is significant uncertainty about the potential for accumulation risk. Political calculations on the amount of economic risk that politicians are willing to bear to protect public health are extremely challenging to model and subject to change with every election. In Europe, for example, 27 member states took 27 different approaches to managing the pandemic. Additionally, if the insurance and reinsurance sector takes on responsibility for most or even some of the losses, the political calculation on acceptable economic risk will certainly change.

The challenges in modelling political calculations is exacerbated by the need to also understand the impact of infectious disease outbreaks on consumer behaviour and demand. Even where governments only imposed limited restrictions, businesses faced significant revenue losses driven by changes in consumer preferences. One example is the case of dry cleaning businesses, which were often allowed to remain open, yet nonetheless faced significant declines in demand for their services as a result of the shift to work from home arrangements.

Uncertainty in the ultimate duration of a pandemic and the containment measures imposed exacerbates the challenges in understanding accumulation potential. While many hoped for a quick return to normal at the beginning of the COVID-19 outbreak, new measures continue to be imposed by governments in various countries over one year later. Mutations of the virus have exacerbated the challenges in predicting ultimate duration. Insurers, reinsurers and capital market investors provide coverage

“The problem with predicting the emergence of dangerous pathogens is that there are nearly an infinite number of ways in which we can have an outbreak or pandemic.”



Dr. Ibrahima Socé Fall, Assistant Director-General for Emergency Response, World Health Organization

“We’ve seen in the last decade and century a lot more outbreaks due to factors that increase the risk of zoonotic disease spread, such as encroachment that leads to more interactions, high density living and increasing international travel – creating a perfect storm.”



Lucia Mullen, Senior Analyst, Center for Health Security, Johns Hopkins Bloomberg School of Public Health

“If governments knew that the market is going to pay for the bill, they will take measures that will be economically biased – they will give priority to sanitary measures at the expense of the economy.”



Denis Kessler, Chair and CEO, SCOR

“As a public company, it’s quite difficult to see how we can insure such an event in the future based solely on the hope that we won’t face enormous losses.”



Frank Sommerfeld,
CEO, Allianz
Versicherungs-AG

“I cannot engage the capital of my shareholders to provide coverage that is not economically justified.”



Denis Kessler,
Chair and CEO,
SCOR

“We need to invest in a global surveillance and alert system as well as a global emergency response system and we need to find a mechanism where countries can coordinate their effort in a more predictable way rather than through improvisation.”



Dr. Ibrahima Socé Fall, Assistant
Director-General
for Emergency
Response,
World Health
Organization

for well-defined events that have a clear beginning and end – not for crises of unknown duration.

A private market offering voluntary coverage for future pandemic risk would also face huge challenges in building a pool that includes both low-risk and high-risk policyholders. Experience with COVID-19 has identified clearly which sectors are most and least affected. There will be little incentive for low-risk sectors to purchase pandemic coverage while those most likely to be forced to close or to face the greatest declines in consumer demand will seek coverage. If that coverage is risk-based, premiums will be high and likely unaffordable for those sectors most at risk. Large-scale government financial support in response to COVID-19 is also likely to reduce future demand for purchasing insurance coverage if businesses assume that government support will be made available the next time.

In the context of a severe event, insurers and reinsurers face the additional risk of the potential for losses from their investments if there is a downturn in financial markets. For capital market investors in insurance-linked securities, whose appetite is linked to there being limited correlation with financial market performance, this risk could significantly impede the availability of capacity.

It’s not that insurers and reinsurers do not wish to support businesses by providing coverage – it’s that many believe it to be inherently uninsurable. Ultimately, insurance and reinsurance companies have a responsibility to manage their business in a prudent way. As a result, insurers and reinsurers are ensuring that exclusions of pandemic, epidemic and/or virus are applied unambiguously across their renewals.

OPPORTUNITIES TO IMPROVE INSURABILITY

Most (re)insurers will only make a material, financial contribution to absorbing these types of losses in the future if some of the challenges to insurability are overcome. Experience with COVID-19 has provided – and will continue to provide – a number of lessons that can contribute to a more effective response to future pandemics and reduce loss potential.

The first set of lessons revolve around the public health response to the crisis. Despite a broad understanding of the potential risk of a global pandemic, most countries were not prepared. There was a delay between the time of first early warnings of a pending health emergency and when governments implemented first responses. In developed countries, hospital-centric health systems that required people to visit a hospital to be tested were not fit for purpose to contain COVID-19. Many countries did not have adequate supplies of personal protective equipment. Public communication was ad hoc, sometimes confusing and often ineffective in changing people’s behaviour. The crisis made clear that health systems in many countries are only resourced to operate at or near the level needed to respond to a severe influenza season – and many were no match for a virus with the transmissibility and severity of COVID-19. A lack of preparedness, delayed reactions and limits in public health sector capacity left countries with little option but to implement extended lockdowns that – while effective in containing the outbreak – had devastating economic and social consequences.

Businesses around the world demonstrated their ability to adapt. Technology was harnessed to support a massive shift to work-from-home and allow businesses to maintain connections with employees, suppliers and customers. Retailers around the world transformed into online marketplaces to adapt to consumer preferences. Accommodation providers transformed their properties into places where COVID-19 patients could recover or emergency responders could stay in isolation from their families in order to reduce the potential for infecting others. For many businesses, COVID-19 has been a wake-up call on the need for increased investment in resilience after a long-period of predictability that may have allowed businesses to focus excessively on efficiency and profitability over risk management. Companies that have focused on ensuring the well-being of their employees, communicating with key stakeholders, responding to changing customer behaviour, managing liquidity and ensuring risk preparedness have adapted more quickly to this crisis.

COVID-19 has also provided huge amounts of data that can be used to improve our ability to quantify the potential losses from future outbreaks. Epidemiological models that estimate infection rates, hospitalisations and mortality can be combined with scores and indices on fear and epidemic preparedness to model both the fear-induced behavioural changes and the government operating restrictions that have driven business revenue losses. Many governments have integrated triggers or considerations such as reproduction rate or intensive care unit capacity into decisions on confinement measures, which allows these decisions to be modelled. These model outcomes can be used both to support improvements in short-term operational planning as well as longer-term decisions on insurance pricing.

There may also be opportunities to leverage other sources of capital to respond to pandemic-related losses in the future. Pandemic risk has been transferred to capital markets as insurance-linked securities since 2003 when the first pandemic catastrophe bond was issued – and has now become a mainstream product in alternative reinsurance markets, particularly for life retrocession. The growth of this market has been hindered by limited appetite to transfer this risk rather than a lack of capital availability, which will surely change as a result of COVID-19. The capital markets focus on low frequency, high severity events, which means that limited historical experience has not been an impediment to making capital available. In some cases, publicly-backed insurance programmes have acted as a catalyst for developing capital market appetite by seeking reinsurance or retrocession from capital market investors for their exposures (such as in the case of Pool Re for terrorism or the National Flood Insurance Program for storm-induced flooding).

“If we find and identify outbreaks early on – we can use a lot of other control factors before we move to high consequence ones.”



Lucia Mullen,
Senior Analyst,
Center for
Health Security,
Johns Hopkins
Bloomberg School
of Public Health

“This event has generated an unprecedented amount of data with respect to many different aspects that will allow a much better understanding of how countries’ responses unfold.”



Nita Madhav, CEO,
Metabiota

“Insurance-linked securities investors are used to dealing with rare events that give very few data points.”



Luca Albertini,
CEO and Founding
Partner, Leadenhall
Capital Partners

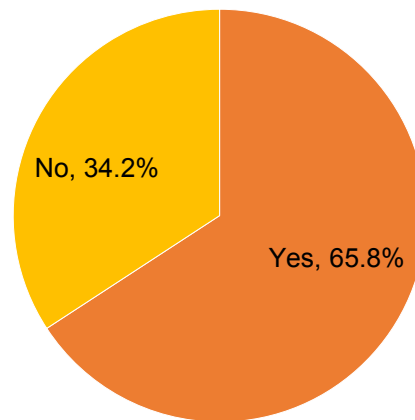
“The pandemic has changed the way that we think about risk and resilience –low frequency, high severity events do happen.”



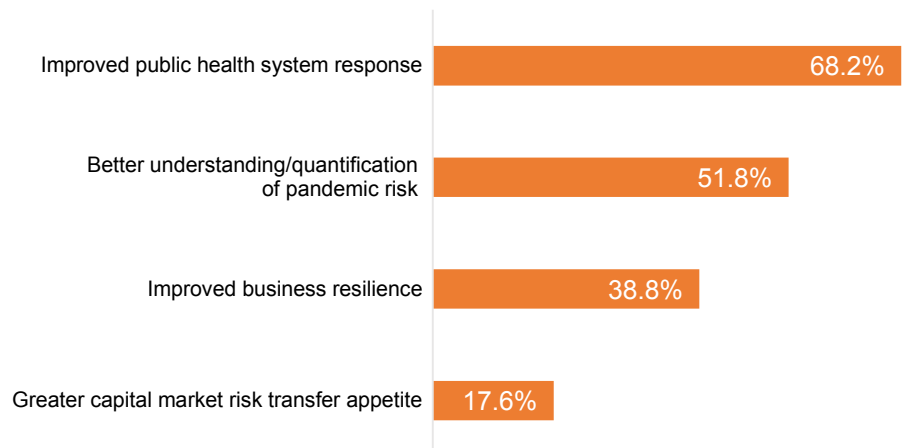
Carolina Klint,
Risk Management
Leader,
Continental Europe,
Marsh

There is some optimism that improvements in preparedness and response could reduce the impact of future pandemics and that the challenges to insurability of pandemic-related business interruption losses can ultimately be overcome.

Do you think that the challenges to the insurability of business interruption losses from pandemics can be overcome?



What preparedness and response improvements will have the greatest impact on reducing the impact of an outbreak similar to COVID-19 in the future?



There are many past examples of how governments and the private sector have come together to reduce risk and restore insurability, whether it be the establishment of fire brigades after the Great Fire of London of 1666 or the creation of the Department of Homeland Security to coordinate security and intelligence responses to terrorism risk in the aftermath of September 11th. What may be needed is a coordinated international effort to address the research and policy gaps that have come to light as a result of COVID-19.

A research and policy agenda to reduce future pandemic risk

Co-ordinated research agenda required: Virological, financial, operational – A ‘pandemic homeland security’?

1. Comprehensive survey and where appropriate eradication of animal reservoir viruses.
2. The design and operation of a worldwide real-time new-disease surveillance system.
3. International rapid containment protocols that work.
4. Contagion quantification research.
5. Optimize contact tracing, quarantine and containment.
6. How to enable socially distanced business, transport and entertainment.
7. Plans in place for rapid expansion of hospitals.
8. Vaccines for a new virus within 3-6 months.
9. Design of platform and modelling capability for comprehensive pandemic risk management optimization.
10. Optimize financial incentives for sustaining businesses including insurance.

Robert Muir-Wood, Chief Research Officer, RMS

BENEFITS OF AN INSURANCE-BASED SOLUTION

For governments, providing financial protection against risks that are uninsurable by private insurance and reinsurance markets alone entails a choice between backing an insurance solution or delivering financial support directly to those in need. An insurance solution could have a number of advantages over direct government financing, particularly where government support mechanisms are established hastily in the midst of a crisis. An insurance solution could provide ex ante transparency and certainty on the level of benefits that will be provided and could leverage the existing claims payment infrastructure to deliver those benefits quickly, particularly if the trigger for paying claims is simple (such as in the case of a parametric coverage). An insurance solution could crowd-in private capital from insurance, reinsurance and capital markets into absorbing some of the losses even in cases where the majority of the risk is borne by the government. An insurance solution could also provide incentives for policyholder risk mitigation through premium discounts.

There is broad consensus around the contribution that the insurance sector can make in distributing payments to impacted businesses. Insurance companies clearly have the payment processes and infrastructure that can be leveraged to distribute funds more fairly and efficiently. Ad hoc government support after any type of crisis often leads to confusion for beneficiaries, numerous adjustments to terms and conditions and benefits that respond disproportionately to the needs of the sectors or stakeholders that have been the most vocal in their demands. Settling business interruption claims is complex and would be difficult for governments to manage.

“Insurance on its own cannot reduce risk – only where a government is pursuing an agenda of effective risk reduction and risk management can insurance prosper.”



Robert Muir-Wood,
Chief Research
Officer, RMS

“In the case of the PPP (paycheck protection program) in the United States, the program was able to distribute a large number of loans in a matter of months – but some of the parametric insurance proposals would be able to distribute payments even more rapidly.”



Lloyd Dixon,
Director, RAND
Kenneth R.
Feinberg Center
for Catastrophic
Risk Management
and Compensation

“A programme that is put in place before can avoid costs and increase efficiency and equity – and ultimately be fiscally responsible.”



Sean Ringsted,
Executive Vice
President, Chief
Digital Officer and
Chief Risk Officer,
Chubb

“Insurance creates the right economic incentives to help harness risk management and drive change in society.”



Flavio Piccolomini,
President, Marsh
International

“Long-term government loans are not good news because that’s always at government’s whim, uncertain, not plannable – we don’t know what government we might have in 5 or 10 years.”



John McVay, Chief
Executive, Pact

“Insurance companies are underplaying their possibilities if they focus solely on the financial aspects of what they can offer.”

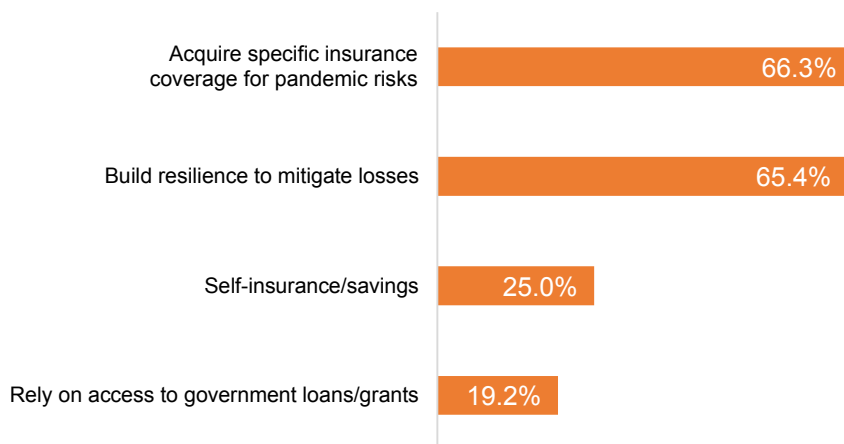


Dirk Wegener,
President,
Federation of
European Risk
Management
Associations
(FERMA)

There is also a broad recognition that the insurance sector has a role to play in supporting risk management. Insurance and reinsurance companies and intermediaries are ultimately risk managers that gather data and create modelling tools to quantify the risks that they assume and provide expertise to their policyholders and society more generally on how to mitigate risk. The insurance sector has enormous amounts of knowledge to share with its clients on how to minimise the impact of risks that do materialise and, through capacity and pricing decisions, the tools to incentivise policyholders to mitigate their risks. A key challenge will be to identify the practices that mitigate risk in the context of a pandemic without causing broader social hardship (e.g., finding ways to mitigate risk without reducing employment).

For policyholders, an insurance-based solution has a number of benefits. There will always be uncertainty as to whether or how governments will make financing available in the context of a future pandemic. For many businesses, especially SMEs, self-insurance is not a viable option as small businesses do not have the capital needed to protect themselves against a risk of this magnitude. Insurance coverage that clearly responds to business interruption or revenue losses in the event of a future pandemic will offer businesses the certainty they need to invest in the growth of their business. It also offers businesses a mechanism for rewarding risk mitigation actions through reduced costs of insurance coverage while providing the flexibility to choose the best mix of options for protecting their business in the future, whether through investments in risk reduction, self-insurance, captives or risk transfer to insurance markets.

How should businesses manage the financial consequences of future pandemics?



BOTH THE PUBLIC AND PRIVATE SECTORS HAVE A ROLE IN SUPPORTING FINANCIAL RESILIENCE AGAINST FUTURE PANDEMICS

Loss-sharing arrangements (or public-private partnerships) between the insurance sector and governments have played a critical role in providing financial protection against risks that are beyond the capacity of private insurers and reinsurers to manage alone. These types of arrangements have been established in many countries around the world to support the availability of affordable insurance coverage for terrorism and natural catastrophe risks as well as to address large-scale industrial accidents such as nuclear liability. In many of these arrangements (but not all), the insurance and reinsurance market provide some level of coverage based on the commitment of the public sector to limit insurance sector exposure with a government backstop for extreme losses.

These catastrophe risk insurance programmes have enabled broad insurance coverage for risks that at one time seemed uninsurable by private markets. By eliminating the potential for extreme losses through a government backstop, these programmes allow insurance markets to develop where they might not have otherwise. In many countries, these programmes have led to broad availability of affordable insurance coverage for the targeted perils and high levels of take-up. Some programmes have also evolved over time to respond to new threats and insurance gaps, such as for cyber-terrorism and terrorism-related non-damage business interruption in the United Kingdom.

While there are inherent differences between pandemic risk and other types of catastrophes, these types of arrangements provide models for addressing the lack of available coverage. Existing catastrophe risk insurance programmes are often seen as the preferred vehicle for delivering a pandemic insurance solution.

However there are differing views as to whether existing programmes are well-suited to provide a pandemic insurance solution. There are a number of challenges, including the need to adapt programmes that have traditionally focused on property damage to respond to business interruptions as well as ensuring that private insurance and reinsurance coverage remains available for an expanded scope of coverage. In Algeria, for example, a separate pooling arrangement has been recommended as a means to ensure contributions from all market participants while not jeopardising the availability of risk transfer options for the existing natural catastrophe reinsurance arrangement.

In many countries, the insurance sector and policyholder groups have put forward specific proposals or concepts for the establishment of a loss sharing arrangement to provide future coverage for various types of pandemic losses that the insurance sector is unable to absorb alone. While there are many areas of agreement, a number of issues related to design and scope of coverage remain subject to ongoing debate.

Should the solution be available to all companies or just smaller companies?

Large companies clearly have a greater capacity to manage this risk and better access to alternative solutions including self-insurance, captives and capital market financing. Including larger companies would greatly increase the amount of funding

“About half of OECD countries have some form of catastrophe risk insurance programme designed to share the burden of flood, earthquake or terrorism losses across the insurance sector and often with governments.”



Angel Gurria,
Secretary-General,
OECD

“Pool Re has been successful in taking a risk that was uninsurable 28 years ago and turning it into something where the insurance industry can take the majority of terrorism insurance risk on its balance sheet – the taxpayer is some GBP 14 billion away from any loss.”



Julian Enoizi, CEO,
Pool Re

“If you have a vehicle already established that works well and that has figured out how the risk sharing works between the government and the pool – with institutionalised risk management, investment in risk modelling and services to manage and advise on risk – this is already a big gain.”



Ivo Menzinger,
Head, Europe,
Middle East
& Africa and
Managing
Director, Public
Sector Solutions,
Swiss Re

“To focus on business interruption is to miss the point that this is a broader problem.”



L. Charles Landgraf,
Representative,
Business
Continuity
Coalition

required and could lead to imbalances in any pooling arrangement established to provide coverage, particularly if coverage is not limited. The inclusion of larger companies would clearly increase the available pool of premiums to fund the eventual losses and would avoid difficult questions of which policyholders should be excluded. In some programme proposals, all companies would be eligible, although different levels and forms of coverage are recommended for smaller companies.

Should the solution be narrowly focused on business interruption and revenue losses or address a larger set of emerging insurance coverage gaps?

Business interruption and revenue losses, including for event cancellation and other contingency lines, were the first types of losses to materialise as a result of COVID-19. However, other gaps in insurance coverage have emerged as insurers have applied pandemic and virus exclusions across a wide-range of business lines in anticipation of potential claims, including various liability lines. In India, the proposal developed by a dedicated working group led by the Insurance Regulatory and Development Authority also includes health coverage for employees in order to address a gap in health coverage for pandemic-related illness.

Should the solution be focused on pandemic-related risks or a broader set of risks with potential “systemic” impacts?

There is a clear desire to not respond only to the last crisis and an understanding that there are a number of risks that could have similar implications as COVID-19 in terms of the types of policyholders impacted and the types of losses incurred (such as large-scale cyber attacks or power outages that could cause business interruption losses for a broad set of businesses simultaneously). However, there is also a recognition that including more perils in any insurance solution will increase the level of complexity in achieving an agreement and could jeopardise the possibility of developing a solution. Some of the proposals that have been put forward, such as Lloyd’s Black Swan Re proposal, are aimed at addressing a broader range of systemic risks.

Should policyholders be required to acquire the coverage provided?

There is a recognition that broad take-up of any coverage offered is critical for the success of the programme, both to ensure financial viability as well as to reduce the pressure on governments to intervene in the future if many businesses remain uninsured. There is a particular risk that the businesses that are most likely to be impacted by government restrictions and changes in consumer demand would be the only ones willing to acquire coverage if it’s optional. However, there is little appetite, particularly among policyholder groups, to require businesses to purchase this coverage as businesses would prefer to have flexibility in how they choose to manage this risk in the future. The success of a voluntary programme in achieving broad take-up among businesses would require that coverage is provided at an affordable premium. In response, some proposals incorporate significant premium subsidies for policyholders in order to ensure affordability. While other proposals recommend approaches that would require policyholders to specifically opt-out of coverage and any claim to future government financial support.

Should insurers be required to make coverage available?

Requiring insurers to make coverage available would ensure that businesses have the ability to acquire such coverage. For other perils, a mandatory offer has led to broader take-up. However, there is a risk that forcing insurers to participate could lead to insurer withdrawals from the market.

What type of compensation should be provided by an insurance-based solution?

There is a general agreement that benefits should be simple to assess in order to ensure capacity to manage large numbers of claims simultaneously and make quick payments. There is a particular need for quick payment of SME claims given their likely need for liquidity. As a result, many proposals recommend a parametric coverage that would pay out a pre-set amount once a coverage trigger (or triggers) are met (which would also have benefits in terms of coverage affordability given the reduced need for loss adjustment). Some programmes differentiate the compensation approach for large and small companies or maintain an indemnity-based approach with an upfront payment of a portion of the claim in order to support business continuity.

The most significant area of ongoing debate relates to the allocation of losses between governments and the insurance sector. Most of the proposals recommend a need for governments to absorb at least 90% of the losses (at least initially), although some proposals allocate all losses to government. In India, insurers and reinsurers (domestic and foreign) have committed to provide the necessary capacity to support a programme targeting micro and small enterprises and their workers. One proposal would provide insurers with the option of ceding 90%, 95% or 100% of the pandemic risk that they assume to a government reinsurance programme. Another provides for the possibility of joint underwriting facilities that would allow insurers with limited appetite to co-insure or reinsure their exposure. The level of capacity that governments and the insurance sector are willing to provide will impact the amount and duration of coverage that an insurance solution will ultimately be able to provide.

A regional solution in Europe

One of the areas of ongoing debate in Europe is whether the optimal solution should involve some loss-sharing at the European-level. The increasing interconnectedness of European markets and supply chains could make a regional solution desirable in order to ensure that companies have equivalent access to financial protection no matter their country of domicile (and support a level playing field). A layer of protection at the European-level would increase the amount of funding available and could also provide some diversification, particularly in the context of more localised outbreaks that might not impact all European Union countries simultaneously. That said, most existing loss-sharing arrangements for catastrophe risks in Europe have been established at the national level. There have also been very different responses to COVID-19 across EU countries which has led to different implications in terms of business interruption and revenue losses. While it may be desirable to have greater coordination of responses and harmonisation of financial support, seeking a European solution would likely increase the complexity in finding an agreement.

“The insurance sector can play a role going beyond the payment of claims, but we need to look at it from the respective roles of the public and private sector.”



Nicolas Jeanmart,
Head of Personal
and General
Insurance,
Insurance Europe

“Marsh McLennan has been actively engaged with close to 42 governments around the world to help form a forward-looking solution to protect businesses from pandemic risk.”



David Priebe,
Chairman, Guy
Carpenter

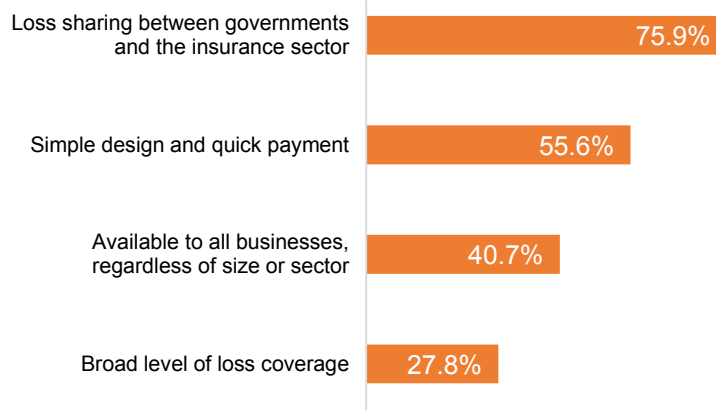
“We know that in developing countries where domestic insurance markets are undeveloped, the role of the public sector in driving the development of PPP solutions is critical.”



Olivier Mahul,
Practice Manager,
Crisis & Disaster
Risk Finance,
World Bank

Ultimately, the design of any programme to address pandemic risk will need to respond to the needs of policyholders and provide a material amount of coverage at an affordable cost.

What do you think are the most important elements of any future insurance solution for pandemic business interruption risk?



The effectiveness of an insurance-based solution will be different for different countries. In countries where there are low levels of insurance penetration and market development, and particularly where the take-up of business interruption coverage is limited, an insurance-based solution might have more limited impact. In these countries, other financial mechanisms such as partial credit guarantees for impacted businesses might offer a more viable approach. Where insurance plays a limited role in providing financial protection, more comprehensive social protection schemes will be needed to protect the most vulnerable. That said, public support for the establishment of public-private partnerships to address “underinsured” risks could encourage the development of private market solutions.

It will also be important to ensure that any established insurance solution complements existing social protection schemes – which vary across different countries. For example, many countries provide significant support for temporarily unemployed workers, which might reduce the share of revenue replacement that would be needed through an insurance solution (although reducing displacement of employees is likely to be a desirable policy goal, which might suggest the need for a higher level of support through an insurance solution).

FINDING A WAY FORWARD

It's been over a year since the first restrictions were imposed in most countries – and many of the core issues remain unresolved. There is some concern that the lack of a solution for many businesses and risks could threaten the economic recovery. Companies have faced significant challenges in finding coverage at renewal for many types of losses. Some insurers have applied either pandemic exclusions or broad bacteria and virus exclusions in general liability coverage renewals that also eliminated coverage for more common health risks such as legionella and norovirus that had previously been covered. In the case of business interruption coverage, absolute pandemic or virus exclusions have been applied universally (where exclusions needed to be confirmed) with no solution available in the market.

In some cases, the application of pandemic and virus exclusions has substantially hindered recovery efforts. In the film, television and streaming sector, for example, despite insurance being critical for protecting producers against the risk of filming cancellations and shutdowns, many insurance companies removed coverage for pandemic. This created incentives to pursue lower risk projects with lower budgets and fewer employees. A similar challenge exists for the live music industry, which requires insurance to protect against the cancellation of live music events.

In some countries, governments have stepped in to provide support for certain sectors, enabling those businesses to resume operations. In the United Kingdom, a publicly-backed indemnity fund has been created for film and television production that has allowed production to (almost) return to levels last seen before the first restrictions were imposed in March 2020. Other sectors, such as live music and businesses involved in organising large events, remain unable to find the needed insurance coverage that will allow them to resume operations when health conditions allow. For those sectors, it may take some time before private market insurance appetite returns.

Without a longer-term solution for the risks that insurance and reinsurance markets cannot absorb alone, business will go uninsured and economic growth will be hampered. The insurance sector may face further reputational impacts if a solution is not found. Some have suggested that there needs to be a shift within the industry towards developing products that address evolving customer needs and are clear on what is covered.

Insurance companies have a responsibility to innovate in order to develop the products that their customers need, including for those risks where the potential consequences might not be well understood. There are many examples – from intellectual property protection to cyber risks – where innovative insurers have extended coverage without a clear and comprehensive understanding of the nature of the risk and the potential losses. However, this type of innovation needs to be prudently managed to ensure that new coverages do not put insurance companies' solvency – or their ability to meet their obligations to their policyholders – at risk.

“The confidence of business and society to get going again will be lost if we don't restore coverage in lines of business that have now applied exclusions.”



L. Charles Landgraf,
Representative,
Business
Continuity
Coalition

The insurance sector needs to get ahead of the curve – so we don't find ourselves in the future facing a similar situation where our customers don't have coverage.”



John Neal, CEO,
Lloyd's

“We should continue to rebuild trust between businesses, policyholders and the whole insurance ecosystem.”



Stéphanie Yon-Courtin,
Member of
the European
Parliament and
Vice-President of
the Committee
on Economic and
Monetary Affairs
(ECON)

“We already have laid the foundation of modelling and pricing epidemic risk. Looking ahead, we need to accelerate the development of this specialist market and jointly create risk transfer solutions for a sustainable and resilient financial global ecosystem.”



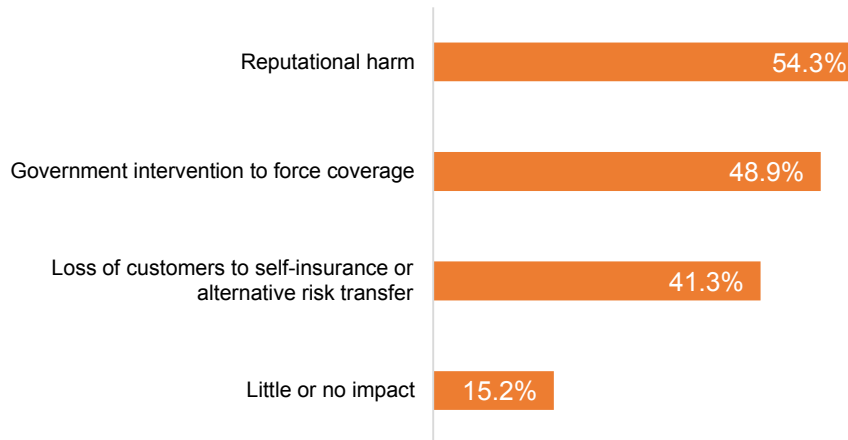
Dr. Gunther Kraut, Global
Head of Epidemic
Risk Solutions,
Munich Re

“We have a tough agenda in front of us but an opportunity to address the weighty issues that face our country.”



Congressman Emanuel Cleaver II,
Chairman,
Subcommittee
on Housing,
Community
Development
and Insurance,
U.S. House of
Representatives

What will be the impact on the insurance industry if insurance coverage for pandemic risk is not provided in the future (with or without government backing)?



Governments also have much to gain from collaborating with the insurance sector on the development of a viable solution for protecting against future pandemic risk. Governments face an implicit contingent liability as the social safety net provider. If businesses find themselves once again without financial protection in the context of a future pandemic, governments will be faced with similar pressure to provide financial support with all the same implications for public finances.

The insurance sector has an opportunity to contribute to reducing governments' contingent liabilities and provide financial protection in response to crises with systemic implications. Many governments around the world clearly recognise the potential benefits of a collaborative solution, although there are signs that some of the early momentum has been lost.

While business interruption coverage for losses was not broadly provided to businesses before COVID-19, some solutions did exist in the market and provide a starting point for how to define, model and underwrite this risk in the future. The insurance sector has been taken by surprise in the past, but has always found a way to build the models, enact the mitigation measures and develop the risk sharing mechanisms necessary to enable a return of market capacity.

Experience with COVID-19 will provide insurers – and society more broadly – with critical lessons on how to better manage this risk in the future.

ABOUT THE CONFERENCE

This conference brought together leading (re)insurance, capital markets, risk management and public health experts from around the world and over 1,500 registered participants. Together they discussed the challenges to providing insurance coverage for business interruption and other commercial risks in the context of a global pandemic – and possible solutions to overcoming these challenges, including through collaboration between governments and the insurance sector. Recordings of these discussions remain available at the dedicated event website: <https://oecd-events.org/protection-gap-for-pandemic-risk/sessions> (registration required).

ABOUT THE OECD

The OECD plays a leadership role in supporting the development of strategies for the financial management of natural and man-made disaster risks and has provided guidance and analysis on these issues for the G20 and APEC Finance Ministers. This work is undertaken under the guidance of the High-Level Advisory Board on the Financial Management of Large-scale Catastrophes and the Insurance and Private Pensions Committee. The OECD provides a unique forum for governments to compare policy experiences, seek answers to common problems, identify good practice, and work to co-ordinate domestic and international policies. For more information, visit oecd.org.

ABOUT MARSH McLENNAN

Marsh McLennan (NYSE: MMC) is the world's leading professional services firm in the areas of risk, strategy and people. The Company's 76,000 colleagues advise clients in 130 countries. With annual revenue over \$17 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses. Marsh provides data driven risk advisory services and insurance solutions to commercial and consumer clients. Guy Carpenter develops advanced risk, reinsurance and capital strategies that help clients grow profitably and pursue emerging opportunities. Mercer delivers advice and technology-driven solutions that help organizations redefine the world of work, reshape retirement and investment outcomes, and unlock health and wellbeing for a changing workforce. Oliver Wyman serves as a critical strategic, economic and brand advisor to private sector and governmental clients. For more information, visit mmc.com, follow us on [LinkedIn](#) and [Twitter](#) or subscribe to [BRINK](#).

