BETTER POLICIES FOR BETTER LIVES

ADDRESSING THE PROTECTION GAP FOR PANDEMIC RISK: SETTING THE SCENE

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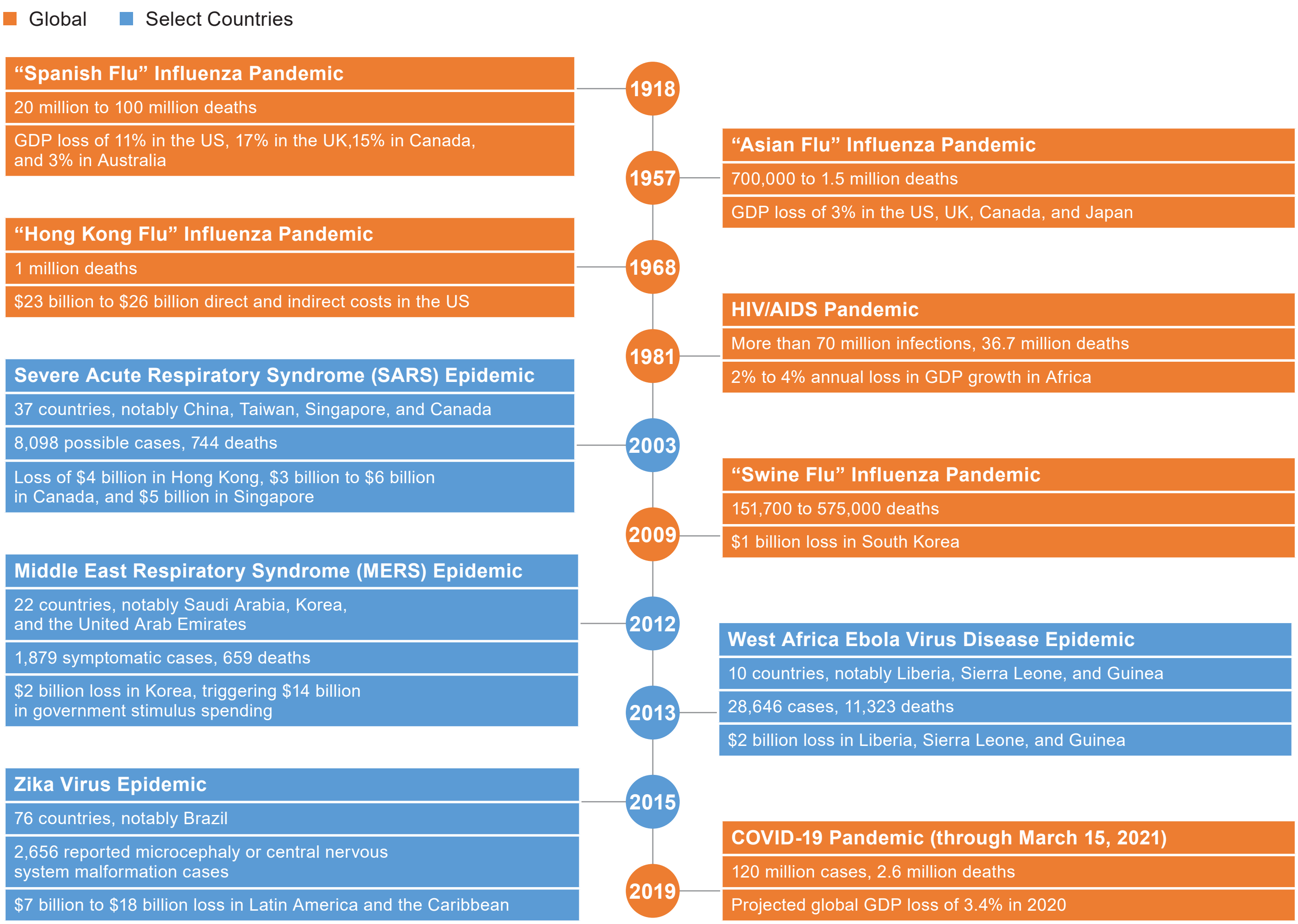
PANDEMICS AND EPIDEMICS HAVE HISTORICALLY HAD SIZEABLE HUMAN AND ECONOMIC COSTS...

COVID-19 is not the first pandemic the world has experienced, nor the first to cause major losses. Nonetheless, no infectious disease outbreak in at least 100 years has caused such broad and devastating impacts on the global economy (see Figure 1).

Gross domestic product (GDP) across Organization for Economic Cooperation and Development (OECD) countries was projected to decline by 3.4% in 2020, the equivalent of USD 6 trillion in lost output, according to the March 2021 *OECD Economic Outlook*. The unemployment rate across OECD countries more than doubled between the first and second quarters of 2020 – from 5.3% to 11.4% of the labour force.

Figure 1: Pandemics and epidemics have had notable impacts on human health and the economy.

Source: Metabiota, World Health Organization, International Monetary Fund.

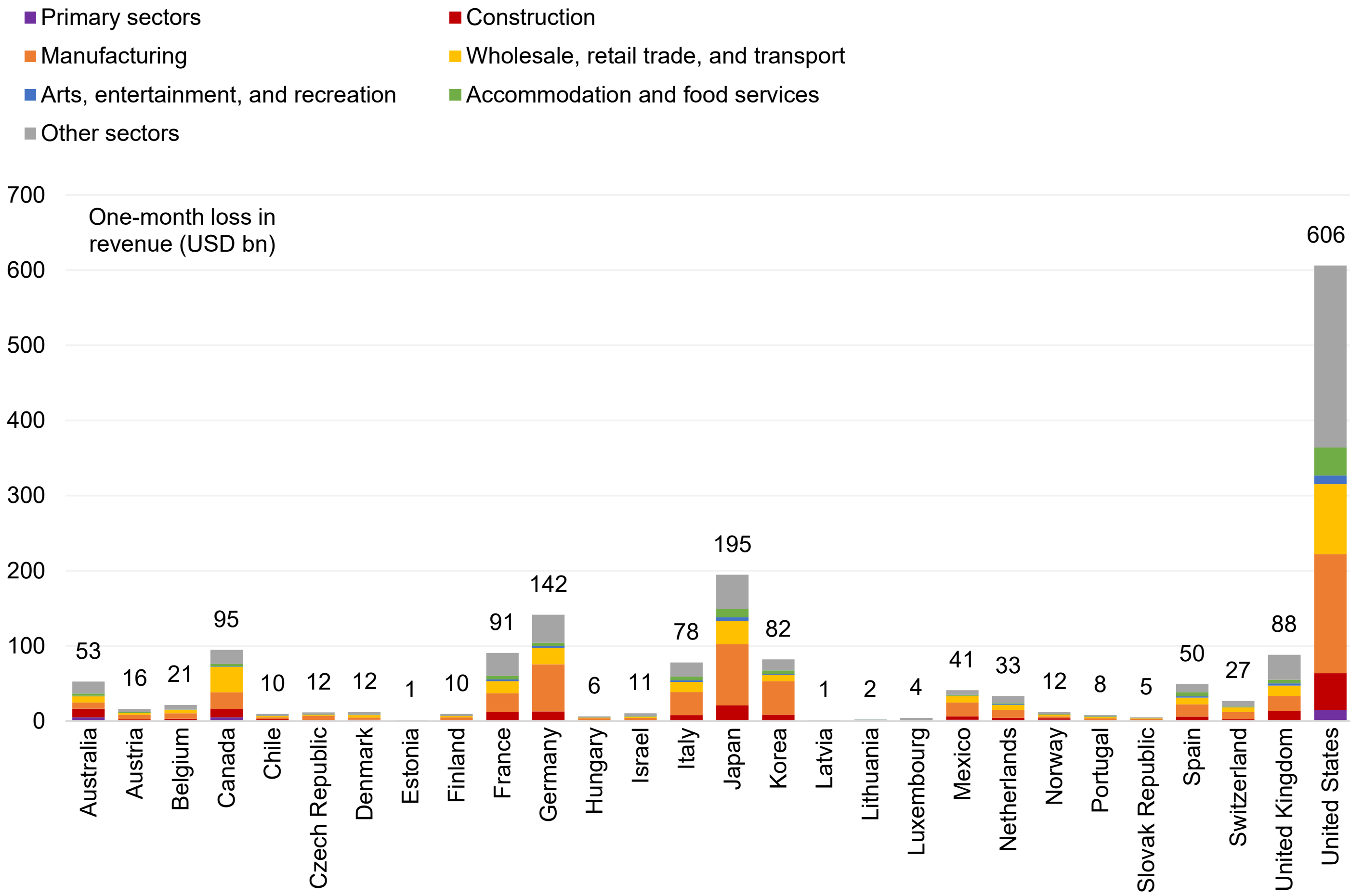


...WITH IMPORTANT IMPLICATIONS FOR BUSINESSES AFFECTED BY PUBLIC HEALTH MEASURES.

The public health measures taken to contain the spread of COVID-19 and protect society's most vulnerable have been particularly hard for businesses forced to severely curtail their operations, or ultimately close. While the impact varied considerably by sector and region, no country or segment of the economy was spared. The OECD estimates that one month of strict confinement measures resulted in approximately USD 1.7 trillion in lost business revenues, with particularly severe impacts on the accommodation, food, arts, entertainment, and recreation sectors (see Figure 2).

Figure 2: COVID-19-related revenue losses across sectors, countries.

Source: OECD, "Responding to the COVID-19 and Pandemic Protection Gap in Insurance" (2021).

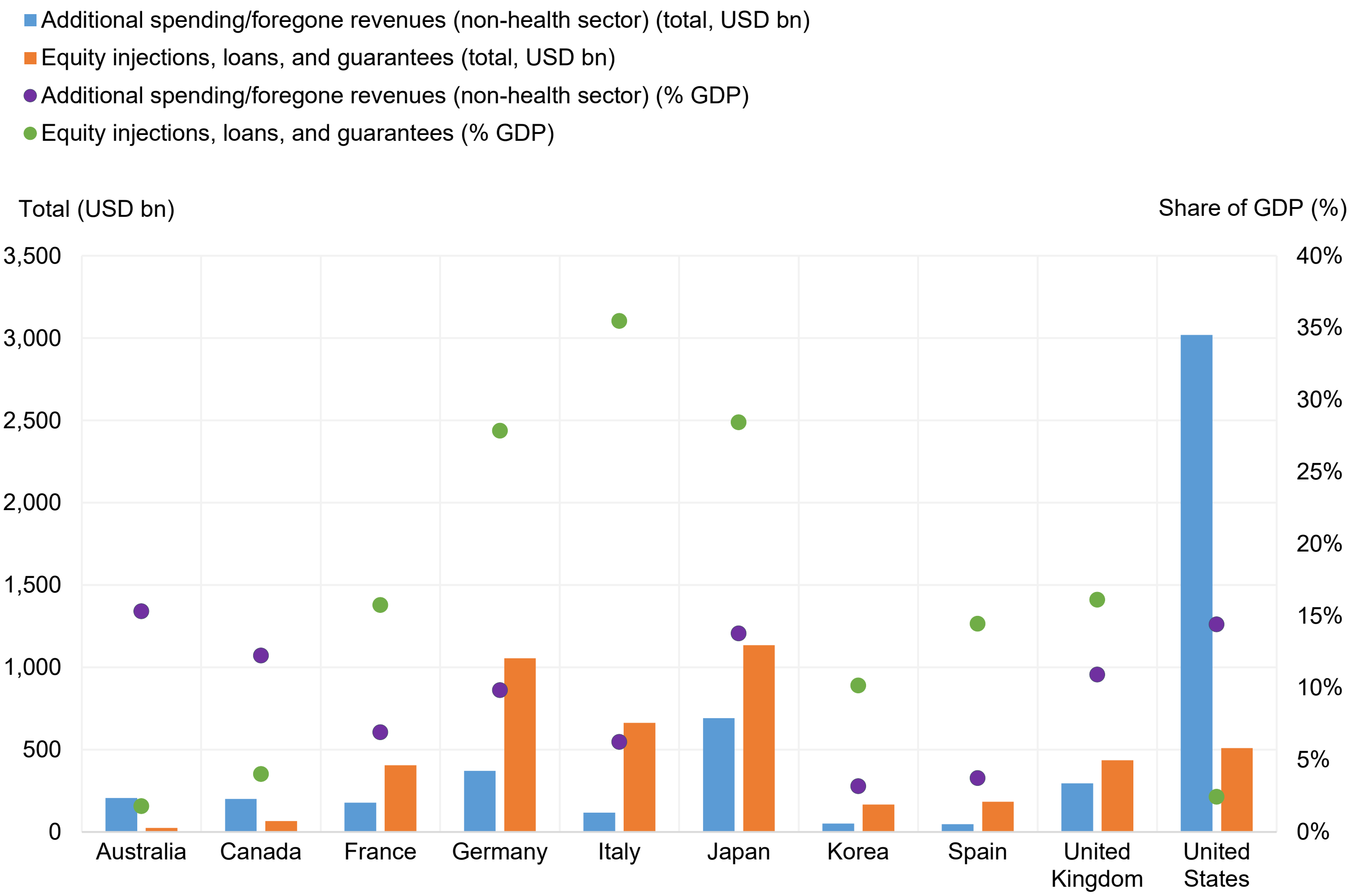


GOVERNMENTS HAVE PROVIDED UNPRECEDENTED AMOUNTS OF FINANCIAL SUPPORT.

Governments in OECD countries have extended unprecedented amounts of financial support to businesses and their employees through wage subsidies, tax deferrals, and guarantees (see Figure 3). According to International Monetary Fund (IMF) estimates, the 10 largest advanced economies have made additional non-health expenditures of more than USD 5 trillion and extended a further USD 4.6 trillion in financial support in the form of equity injections, loans, and guarantees.

Figure 3: Governments extending unprecedented financial support during the pandemic.

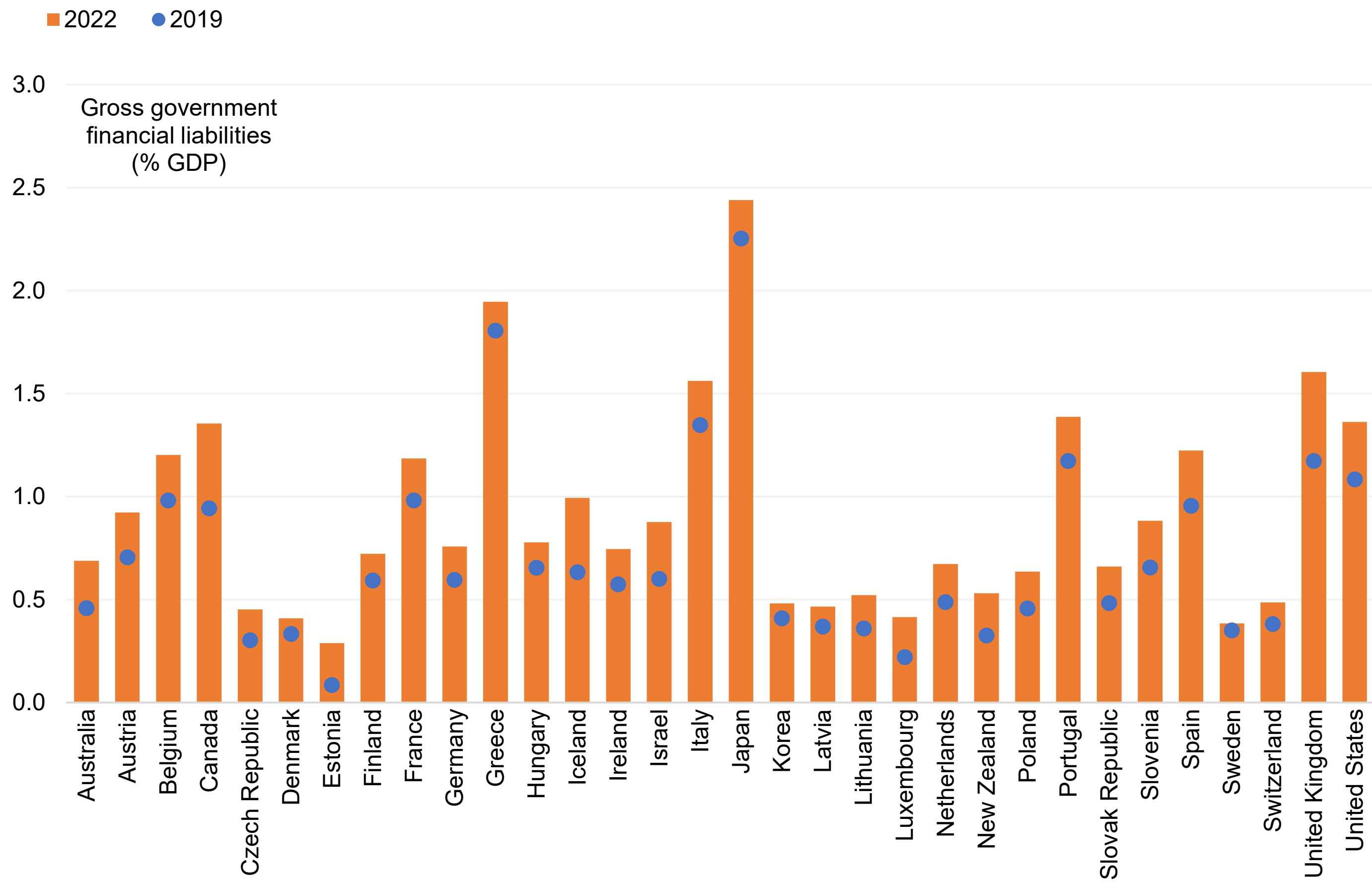
Source: IMF, "Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic" (2020).



This extraordinary level of support has been critical in mitigating the impacts of the decline in economic activity, although it comes at a heavy cost to public finances (see Figure 4). The OECD estimates that, by the end of 2022, government debt-to-GDP ratios in OECD countries will be approximately 20% of GDP higher than 2019 levels. In many economies, government debt-to-GDP ratios will reach their highest level in at least 40 to 50 years.

Figure 4: Support to economies during the pandemic brings a heavy cost to public finances.

Source: OECD, "Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic" (2020).

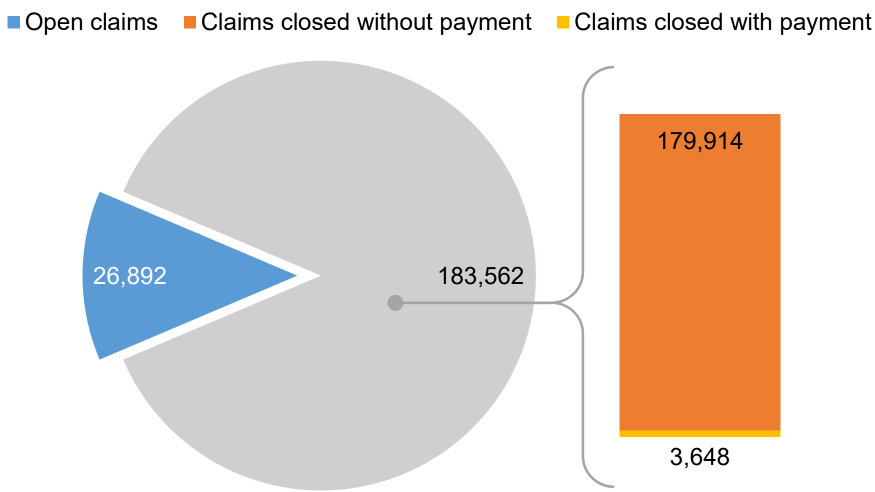


LOW LEVELS OF INSURANCE COVERAGE FOR NON-PHYSICAL DAMAGE BUSINESS INTERRUPTION LOSSES IS A COMMON THEME ACROSS COUNTRIES.

Levels of potential coverage vary by country, but in several geographies it is limited for non-physical damage business interruption (BI) losses. Many traditional property damage and BI insurance policies do not provide explicit coverage for BI losses in the context of a pandemic or other infectious disease outbreaks. BI coverage is often only triggered upon the occurrence of physical damage, and some policies apply exclusions for damages or losses resulting from a virus. However, several policies offer coverage for BI caused by notifiable disease, denial of access, or a hybrid of the two, without requiring physical damage to property. As a result, in many countries, submitted claims for coverage have been denied (see Figure 5).

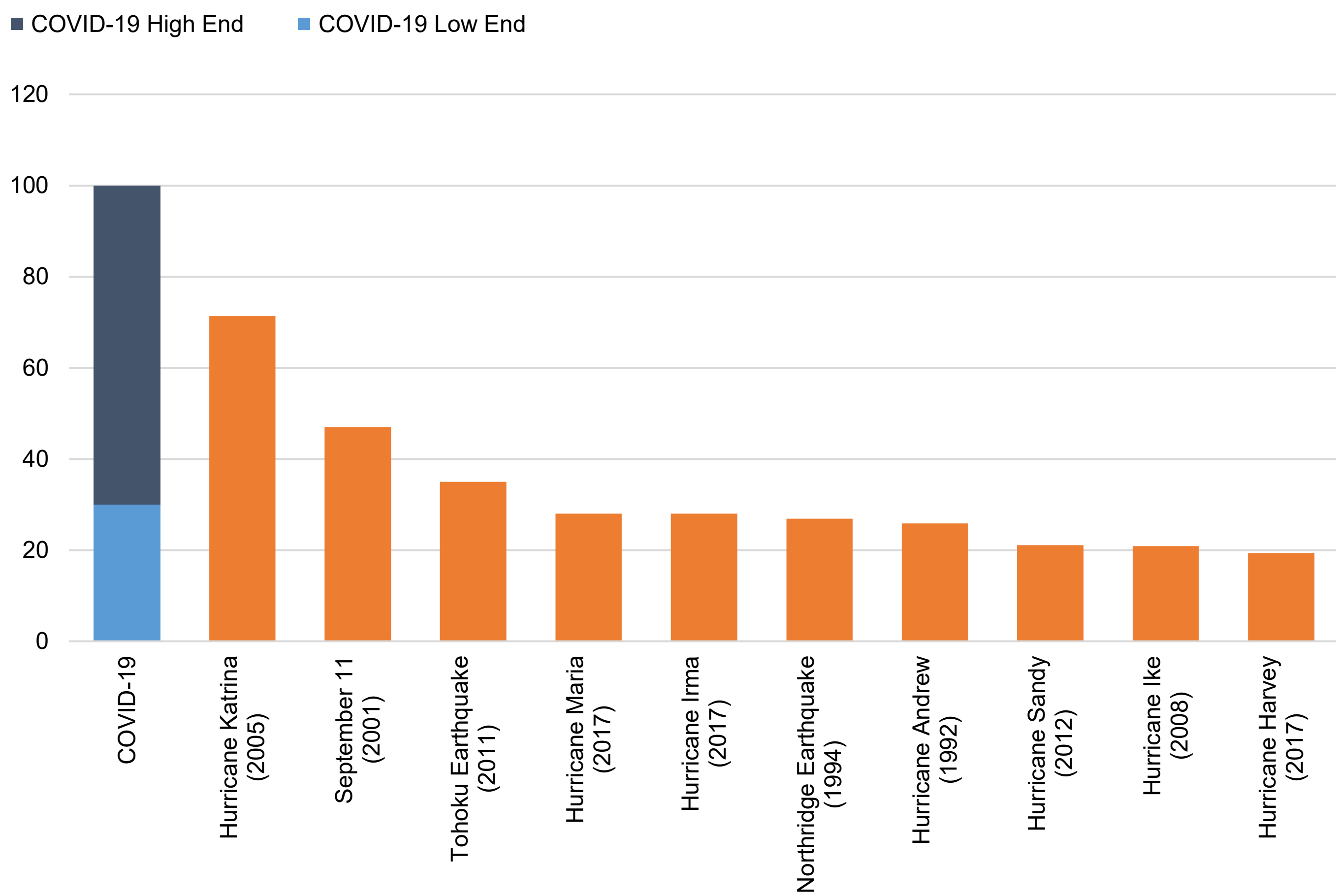
Figure 5: Few business interruption claims being paid during the pandemic.

Source: NAIC, "COVID-19 Property & Casualty Insurance Business Interruption Data Call" (2021).



However, policy language varies globally and some policies that provide coverage for business interruption and event cancellation have responded. While the overall share of policies that provide applicable coverage is small, even the moderate coverage for the unprecedented scale of COVID-19 losses is likely to generate significant losses for the insurance industry (see Figure 6). There are ongoing court cases in a number of jurisdictions related to the interpretation of whether business interruption is covered, even where policies may not provide explicit coverage for BI losses in the context of a pandemic or other infectious disease outbreak.

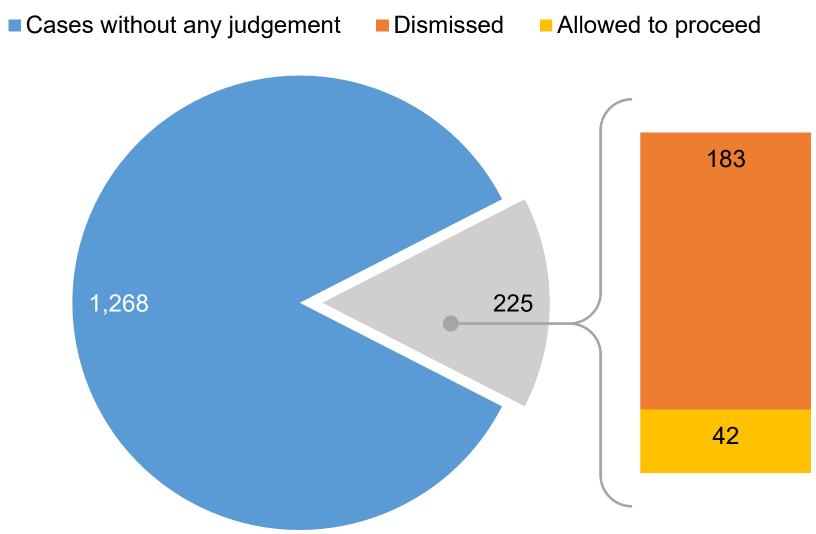
Figure 6: Estimated total COVID-19 losses could top the largest insured losses to date.
Source: Guy Carpenter.



UNCERTAINTY ABOUT COVERAGE HAS LED TO A LARGE NUMBER OF DISPUTES AND LITIGATION.

In a few countries – such as Australia, South Africa, the United Kingdom, and Ireland – notable cases have been submitted to courts, which may provide guidance as to how disputes should be resolved. The outcome of the UK's Financial Conduct Authority (FCA) test case, for example, will likely affect the level of coverage that is ultimately provided. In other countries, numerous claims disputes are being pursued through litigation. In the United States, over 1,000 court cases are pending. As few final judgements have been delivered, it remains unclear whether a broad level of coverage for COVID-19-related BI will be provided (see Figure 7).

Figure 7: COVID-19 business interruption coverage cases are working their way through US court systems.
Source: Baker, T. "Covid Coverage Litigation Tracker" (2021).



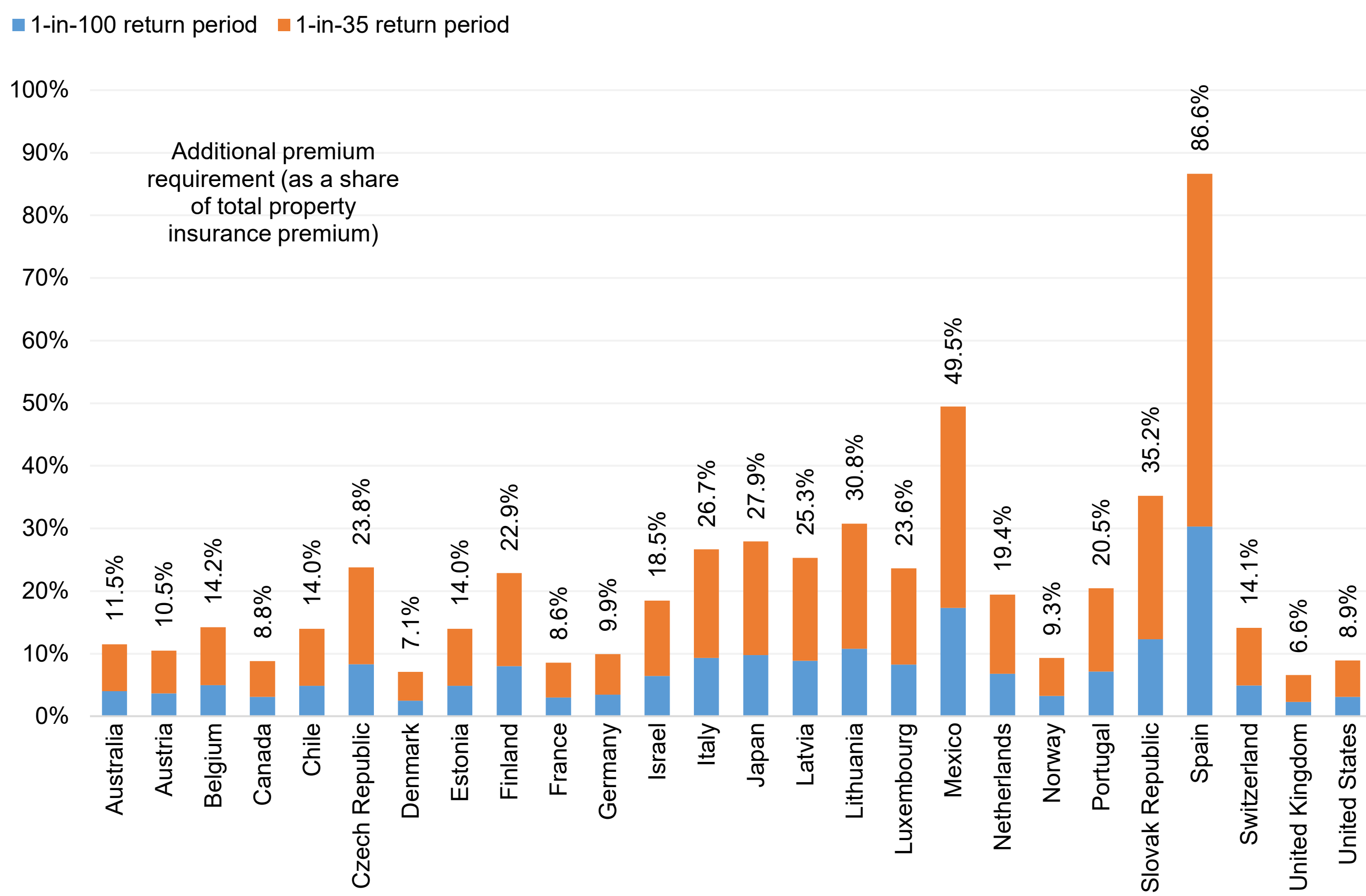
THE MAGNITUDE OF POTENTIAL LOSSES AND HIGH LEVELS OF CORRELATION MAKE PANDEMIC RISK CHALLENGING TO INSURE.

A global pandemic that requires the types of public health measures taken in response to COVID-19 does not meet some of the criteria for a risk to be deemed "insurable." The frequency and severity of infectious disease outbreaks are challenging to estimate, and the magnitude of potential losses and high levels of correlations makes it impossible for even the largest reinsurers to establish the level of diversification upon which the insurance business model is based.

While infectious disease outbreaks may become increasingly common, the relative infrequency of global pandemics involving diseases with airborne transmission – combined with the lessons learned by public health systems through the response to COVID-19 – could limit future risk and resulting losses. OECD estimates of the premiums that would be needed to provide some coverage for these types of losses for a similar event are large – but not insurmountable. They amount to 10% or less of current property insurance premiums collected in almost all OECD countries (see Figure 8).

Figure 8: Additional premiums would be required to cover some future pandemic losses.

Source: OECD, ""Responding to the COVID-19 and Pandemic Protection Gap in Insurance" (2021).



LOSS-SHARING ARRANGEMENTS THROUGH A PUBLIC-PRIVATE PARTNERSHIP WOULD LIKELY BE NECESSARY TO ACHIEVE BROAD COVERAGE IN THE FUTURE.

Catastrophe risk insurance programmes that provide insurance, co-insurance, reinsurance, or a government backstop for households and business losses can support the availability of affordable insurance coverage – and ultimately limit public financial exposure to catastrophe losses that are difficult to insure (see Figure 9). Overall, these programmes have led to broader levels of financial protection against natural catastrophe and terrorism risks, leveraged private market insurance and reinsurance capacity, and supported the development of the analytical and modelling tools necessary for assessing these risks and underwriting insurance coverage.

Figure 9: A public-private insurance/reinsurance mechanism can be developed in several ways.

Source: Guy Carpenter, Marsh.

Private ← → Public

Semi-Private Pooling Reinsurance Scheme

- Joint entity created by insurers to pool risk and share knowledge.
- Participation may be voluntary or legally mandated.
- Financing primarily provided by the private sector, with limited (if any) initial government financing and typically no committed reserve.

Public-Private Partnership (PPP) Reinsurance Schemes

- Structured risk sharing model between policyholders, insurers, and government.
- Government explicitly provides backing to the private sector to cap exposure and drive affordability.
- Participation may be voluntary or legally mandated.

Public Funds for Noninsurable Risks

- Pure government setup, without any direct private involvement (other than aligning coverage).
- Fund is created with a reserve, built up over time, that can be used to pay out claims in the event of a pandemic.
- Claims against the fund should be aimed at covering risk events that cannot be covered by existing insurance offerings.

Relevant Options for Managing Pandemic Risk

Given their global nature, pandemics are unlikely to offer insurers and reinsurers any diversification. Some form of public support will likely be required to enable viable insurance and reinsurance markets.

A NUMBER OF PROPOSALS FOR PROVIDING INSURANCE COVERAGE FOR PANDEMIC-RELATED BUSINESS INTERRUPTION HAVE BEEN MADE.

COVID-19 has highlighted important coverage gaps for pandemic risk. Over the past several months, there has been an impressive focus on creating solutions that both mitigate and protect communities and businesses from potential future pandemic events.

Insurance and reinsurance companies and associations, risk management groups, and policymakers around the world are developing potential approaches to providing broader coverage for pandemic-related BI (see Figure 10). The approaches differ in terms of the type of coverage that would be offered, the perils covered, the scope of eligible policyholders, and the level of government involvement.

Figure 10: Various approaches are being proposed to broaden pandemic-related business interruption coverage.
Source: OECD, Marsh, and Guy Carpenter.

Proposal	Distribution	Type of coverage	Compulsion	Perils	Eligible policyholders	Coverage trigger	Payout approach	Loss distribution	Policyholder or programme limits
EIOPA (Europe)	Insurance sector (bundled with other coverage)	Non-damage business interruption (potentially parametric)	Not specified	Pandemic	SMEs (potentially)	Not specified	Not specified	National government (third risk layer) Europe (fourth risk layer)	Not specified
CATEX (Fédération Française des l'Assurance)	Insurance sector (attached to commercial property or business interruption policies)	Business interruption (resilience capital)	Not specified	Extraordinary events (cyber, terrorism, pandemic, etc.)	No restriction	Health emergency declaration and closure order	Calculated based on % of lost revenue in sector of activity	Reinsurance provided by public reinsurer (CCR)	EUR 500,000 (50% of gross margin lost excluding payroll and profits for maximum of 3 months)
GDV (Germany)	Insurance sector (levy or policy extension)	Business interruption	Voluntary and compulsory models	Pandemic (or epidemic)	No restriction	WHO/German authority declaration	Pre-determined payment amount	Government retrocession/ guarantee (highest layer)	Not specified
ReStart (Lloyd's)	Insurance sector	Business interruption	Voluntary	COVID-19	Small companies (potentially all SMEs)	Evidence of health emergency and revenue decline	Not specified	No requirement for government backstop	Not specified
Recover Re (Lloyd's)	Insurance sector (stand-alone, multi-year policy)	Non-damage business interruption	Compulsory purchase	Pandemic and other perils	No restriction	Evidence of health emergency and revenue decline	Formula that takes into account actual level of disruption	Government guarantee against default on future premium payments	Not specified
Black Swan Re (Lloyd's)	Insurance sector	Non-damage business interruption (systemic event)	Mandatory offer or purchase (potentially)	Systemic risk perils	No restriction	Not specified	Not specified	Government backstop for reinsurance pool	Not specified
Pandemic Risk Insurance Act (United States)	Insurance sector	Business interruption and event cancellation	Mandatory offer	Pandemic and infectious disease outbreaks	No restriction	Certification by Secretary of Health and Human Services	Indemnity	5% industry retention and 5% industry co-insurance above retention	USD 750 billion programme limit
Business Continuity Protection Program (APCIA, NAMIC, Big I – United States))	Insurance sector (stand-alone policy)	Business interruption	None	Pandemic	No restriction (although coverage amounts are smaller for larger companies)	Health emergency declaration and closure order	Parametric	No industry share	80% of eligible operating expenses for up to 3 months policyholder limit

Proposal	Distribution	Type of coverage	Compulsion	Perils	Eligible policyholders	Coverage trigger	Payout approach	Loss distribution	Policyholder or programme limits
Pandemic Business Interruption Program (Chubb – United States)	Insurance sector	Business interruption	Mandatory offer for SME programme	Pandemic	SME programme and larger company programme	Pandemic declaration and closure order	Parametric (SMEs) Indemnity (large companies)	6% retention up to USD 15 billion (SME programme) 5% retention up to USD 15 billion (larger companies) Industry share to increase over time	USD 750 billion programme limit (SME programme) Up to 3 months of expenses (based on multiple of payroll expenses) policyholder limit) USD 400 billion (larger companies) (USD 50 billion per month for up to 8 months) programme limit
Zurich North America draft concept (United States)	Insurance sector	Business interruption	Mandatory offer	Pandemic	No restriction	Health emergency declaration and closure order	Parametric	Individual companies may choose to cede 90%, 95%, or 100% to government reinsurance pool(s)	80% of expenses for up to 3 months (policyholder limit) USD 20 million per month programme limit
Business Continuity Coalition (United States)	Insurance sector	Business interruption and event cancellation	Mandatory offer	Pandemic	No restriction	Health emergency declaration and closure order	Parametric	Government reinsurance for 95% of losses (first event) and 90% of losses (second event)	80% of eligible operating expenses for up to 3 months policyholder limit (SMEs) – declining to 50% of eligible expenses for larger companies

MOVING FORWARD...

The COVID-19 pandemic has shaken the global economy like few other events. Although there is currently hope that the ongoing delivery of vaccines and other preventative measures will soon end the pandemic's worst impacts, it is critical to prepare for similar events in the future.

A loss-sharing arrangement between governments and (re)insurers for future pandemics established through some form of public-private partnership would make a significant contribution to reducing this risk by embedding resilience measures and managing losses from similar events in the future. Such an approach would leverage not only the financial capacities of insurance and capital markets, but also support better risk management and enhance resilience against future pandemic risk.

ABOUT THE CONFERENCE

The necessary imposition of public health measures to contain the spread of COVID-19 has had serious implications for those businesses required to reduce their activities in response, particularly for small and medium enterprises. At the same time, it is unlikely that the insurance coverage held by the vast majority of businesses globally will cover the losses that have been incurred. As a result, a number of insurance sectors and governments around the world have initiated discussions on possible solutions for providing greater financial protection for this risk in the future. This conference will share the experience on addressing the challenges to insuring this risk across countries and finding possible solutions through public-private collaboration. In particular, it is being set up so that legislators of relevant countries can be better informed of options and experiences in other countries.

To learn more about the conference and to register, please visit: www.oecd.org/daf/fin/insurance/addressing-protection-gap-pandemic-risk.htm.

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.

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