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Coronavirus response: Short- and long-term actions for P&C insurers

The COVID-19 pandemic brings unique challenges to commercial, specialty, and personal lines insurance. Several actions can help companies navigate the crisis.

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The rapid evolution of the COVID-19 outbreak makes it difficult to predict the full effect of its tragic human, economic, and geopolitical consequences with certainty. The global insurance industry is intertwined with a broad spectrum of economic activities, so the pandemic is likely to affect the property and casualty (P&C) insurance operating model as we know it today on several fronts. In addition to presenting immediate and considerable operational challenges, the pandemic will hinder mid- and longer-term growth and profitability. It also reinforces the urgency of accelerating product innovation and digital transformation—efforts that were already underway at many companies—to help the industry more effectively serve customer needs in this changing environment.

In this article, we outline the unprecedented challenges brought by COVID-19; offer a perspective on the forecast for commercial, specialty, and personal lines, including business interruption coverage; and outline priorities for P&C insurers to consider as they navigate the crisis.

Unprecedented challenges

We expect both the short-term and long-term behavioral and economic impact of the crisis to have diverse implications for the various P&C lines, which in aggregate will challenge the economics of the industry. Across segments, carriers that are unable to reduce costs in line with reductions in premiums will see expense ratios deteriorate. Some lines within P&C may face the prospect of higher-than-anticipated loss experiences.

Above all, insurance companies will confront the same business-continuity and operational challenges faced by all industries. Indeed, every facet of P&C operations will be affected—from frontline sales, to underwriting, to back-end policy administration, to claims management. While some carriers and agents have made progress in automation and digital engagement, the industry generally remains reliant on manual processing and face-to-face interaction. Remote-working environments may stretch technology bandwidth, impede capability building and collaboration, and decrease the workforce's productivity. New business in most segments will be lower during the crisis. And the likelihood of second-order challenges, such as fraud and early policy cancellation, will be heightened.

Short- and long-term challenges

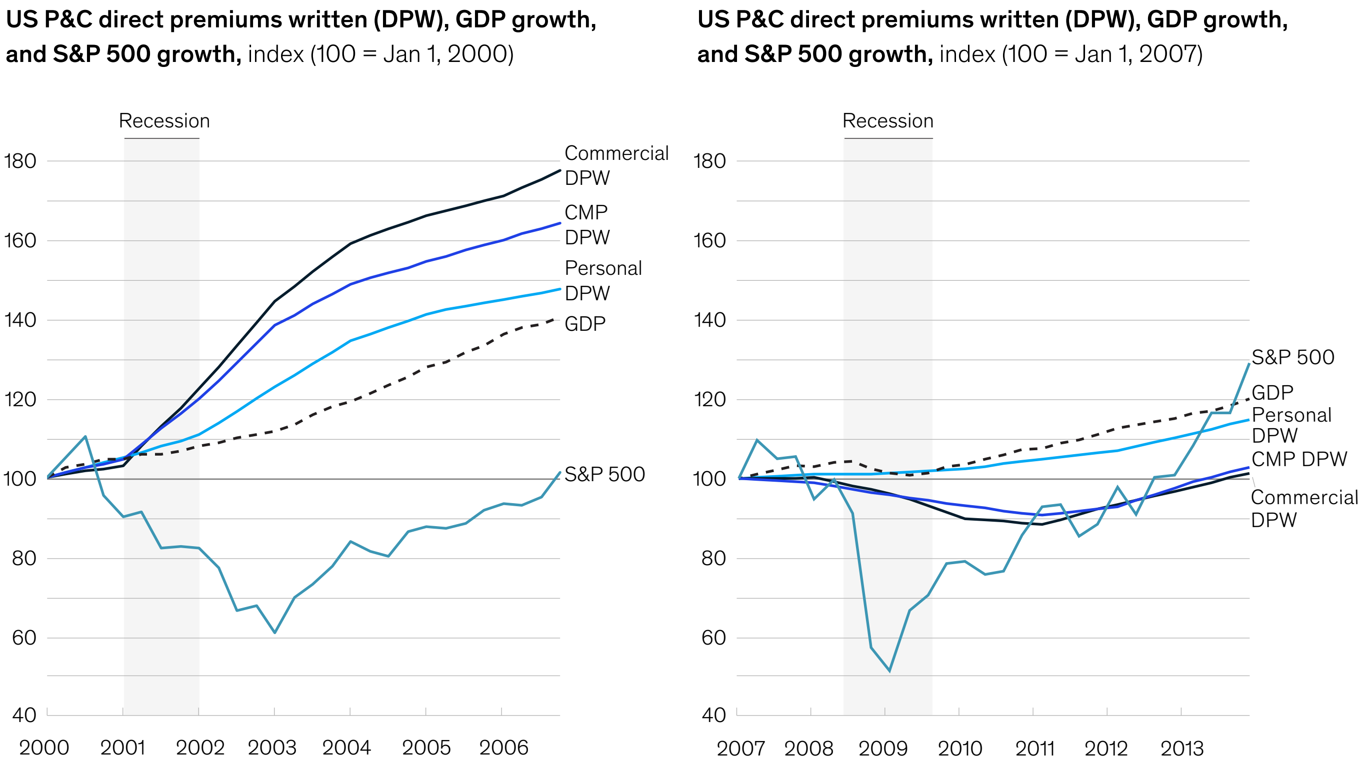
The most immediate impact on insurance companies is the risk incurred by many employees' sudden shift to remote working. Some functions, such as claims adjusting, typically require employee presence in the field. Most carriers do not yet have the digital tools and platforms to enable those employees to work entirely remotely. Even those who technically can work fully remote may struggle to adjust to this new way of working, especially at first. Remote working tends to inhibit cross-functional collaboration—which is particularly crucial for the claims, underwriting, and actuarial functions. It can also make decision making more inconsistent on multiple levels—from executives steering the portfolio to the frontline workers making claims and underwriting choices, resulting in higher leakage and potentially poor results.

Low interest rates will cause many P&C insurers to face decreased normalized earnings. If rates remain low, particularly in the long term, this would add another challenge for P&C players. Prolonged low rates would disproportionately affect the economics of longer-tail lines of business, and some lines will risk becoming uneconomical to write. In the near term, market contraction will lead to drawdowns in the portfolio, particularly for equities.

There will also be repercussions for growth. P&C insurance growth depends on both exposure (economic units) and rate cycle (insurance pricing), so growth is possible even in times of economic decline as long as pricing is improving. In the United States, the P&C industry's growth during the 2001–02 recession remained mostly solid (Exhibit 1). The industry performed relatively steadily through the Great Recession as well,

Exhibit 1

Commercial lines insurance tends to be more vulnerable than personal lines to the economic cycle.



Source: SNL Financial, FRED

though it is clear that commercial insurance is more vulnerable to economic conditions compared with personal insurance.

Impact on commercial and specialty lines

At a more granular level, the impact on commercial lines will vary by type of coverage (Exhibit 2).

Core lines: Volume decline

Across core property and liability coverages, most of the direct effects will be felt by lines that are priced based on payroll or company revenue, as well as other exposure units that directly decrease with economic contraction. For instance, as unemployment rises, payroll will decrease—reducing the need for workers' compensation products in countries that offer it, including Australia and the United States. In many cases, this impact will be felt as soon as the second quarter of 2020 as premium adjustments reflect lower staffing levels.

Property premiums may decline as customers cut costs by consolidating assets and inventory into fewer buildings. Within liability lines, the pandemic brings a higher risk of allegations that policyholders have failed to provide adequate protection (for example, masks, hand sanitizer, cleanliness, hazard warnings, and proper physical-distancing protocols). Across both property and liability, the small commercial segment will be hit the hardest, as small businesses are typically the most sensitive to economic conditions. Small businesses account for about one-third of global commercial markets, on average.[1] Depending on the length and severity of the economic constriction, this segment will be heavily distressed as small companies struggle to sustain

[1] McKinsey Global Insurance Pools.

Exhibit 2

The COVID-19 pandemic will have an impact on all commercial insurance lines.

↑ Positive ↓ Negative → Stable ? Unknown

		Short- to medium-term implications		
		Premium volume	**Loss ratio deterioration**	**Long-term implications**
Core coverages	Property (physical damage)	→ Limited short term	→ Limited short term	
	Property (business continuity)	? Perceived lack of value added	↓↓ Excluded—but may be challenged	Threat to relevance if excluded in future
	Casualty	? Depends on revenue levels	↓ Allegations of negligence or injury	Long-tail lines becoming uneconomical to write due to lower interest rates
	Worker's comp.	↓ Depends on head-count levels	? COVID-19 not considered work-related condition?	
	Motor fleet	? Varies based on size of fleet	↑ Lower frequency	
Professional liability lines	Cyber	↑ Increased demand	↓ Increased cyber crimes	Repricing
	Directors and officers	? More demand with more strain?	↓ Allegations of unpreparedness	Possible introduction of pandemic exclusions; introduction of risk-management services for pandemics
	Errors and omissions	? More demand with more strain?	→ Limited short term	
	Healthcare prof liability	↑ Increased need and exposure	↓ Claims from healthcare at overcapacity	Repricing
Specialty lines	Aerospace and marine	↓↓ Less travel and transit	→ Limited impact (losses are severity driven)	Reduced demand until global trade recovers
	Construction	↓ Slowdown in construction activity	↓ Struggling contractors	
	Energy	↓ Less upstream activity	→ Limited impact	
	Event cancellation	↓ Slowdown	↓↓ Claims in 2020 policy year	New/clarified pandemic exclusions
	Credit and surety	↓ Reduction of global trade	↓ Increased financial distress	
	Political risk	↑ Increased demand	? Pandemic-related closures possibly trigger coverage	

Note: Current view as of April 7, 2020; perspective to be updated as the situation unfolds.

their activity (and many will go out of business) alongside a slowdown in new business formation.

Professional liability lines: Increased demand, potential increase in litigation

Several professional liability lines may see more claims activity. Cyber insurance will face increased losses given the heightened vulnerability introduced by an expanded remote workforce—for example, employees who may or may not connect through approved virtual private networks. Security standards in a home-office environment are generally less robust than the typical office environment, and cybersecurity experts have described an uptick in cyberattacks (including phishing and network attacks) taking advantage of the COVID-19 crisis.[2]

Directors and officers insurance often sees increased claims activity when the economy moves into a recession. Additionally, specific to

[1] Davey Wynder, "FBI coronavirus warning: 'Significant spike' in COVID-19 scams targeting these three states," *Forbes*, March 21, 2020, forbes.com.

this pandemic, shareholders may contend that management was negligent in foreseeing and handling COVID-19 risk. Allegations could include failing to develop adequate contingency plans, not observing the protocols recommended by authorities, and not properly disclosing the risks the pandemic poses to the company's performance, among others.

Healthcare professional liability and medical malpractice is another clear area of concern. The heightened exposure of medical personnel to COVID-19 could result in elevated claims activity.

Specialty lines: Slowdown until global trade recovers

Certain specialty markets, such as aviation, marine, and construction, will be affected by reductions in global travel, trade, and new builds during the crisis. They may benefit from reduced loss exposure in the immediate future (as the use of underlying assets has rapidly reduced) but will struggle to reach pre-crisis levels of activity until global trade activity fully resumes.

Credit and surety loss ratios will also suffer as the crisis leads to halts in economic activity and more companies experience financial distress. During previous recessions, surety typically saw higher loss ratios in adverse economic conditions, as projects became more difficult to complete and contractors' capital positions were impaired.

Event cancellation is a relatively small line globally but will be among the hardest hit. Many events around the world planned in the second and third quarters of 2020 are being canceled or delayed given the imperative of physical distancing to slow the spread of the COVID-19 outbreak and to prevent overloading the healthcare system. The unprecedented number of concurrent cancellations will most certainly result in significant claims exposure. For instance, leading reinsurers have publicly communicated that their exposures to the 2020 Tokyo Olympics, which have been delayed until 2021, could cost hundreds of millions of dollars.[3]

Business interruption coverage: Are pandemics covered?

Another potential exposure for insurance companies comes from business interruption coverage, which is typically included in property policies and indemnifies companies for loss of profits if the business is shut down for reasons specified in the contract. Typical all-risk commercial property policies insure against *direct* physical loss or damage to covered property resulting from any *nonexcluded* risk.

Generally, diseases such as COVID-19 are excluded as an insured peril (unless added by endorsement). Most policies exclude losses from viruses, bacteria, or other contaminants, which are usually not viewed as causing physical loss. However, there will be challenges and litigation addressing whether COVID-19 has caused direct physical loss at insured locations. In the United States, case law differs by jurisdiction. Some courts have held that contamination by semitangible biological or chemical agents can constitute direct physical loss if the contamination impairs the function of the property, making it unusable for its intended function. In these cases, the presence of COVID-19 could be considered a direct physical loss. However, in other jurisdictions, there is a high bar to confirm the presence of a physical contaminant, and courts will be reluctant to view COVID-19 as the cause of direct physical loss.

Many traditional property insurance policies include civil authority coverage, which addresses loss of income due to government shutdowns that cause an inability to access insured premises. However, triggering this coverage also requires civil authority action to be attributed to direct physical loss. Currently many businesses are shut down as part of voluntary or government-mandated efforts to shelter in place and prevent the *spread* of

[2] "Industry set to dodge $2.6bn Olympics loss on postponement decision," *The Insurer*, April 3, 2020, theinsurer.com.

contamination, not because of *actual* contamination. Policy wording would suggest there is no direct physical loss without actual physical contamination or a direct shutdown of adjacent property, and therefore coverage would not apply.

Regulators across several states have issued bulletins clarifying that pandemics are generally excluded. The Maryland Insurance Administration likened COVID-19 to nuclear war, which is an excluded loss under typical insurance policies, since "potential loss costs from such perils are so extreme that providing coverage would jeopardize the financial solvency of property insurers."[4] However, we are starting to see pressure from legislative bodies to take a more expansive view of coverage. For instance, a March 18 bipartisan statement by 18 members of the US Congress urged insurers to "recognize financial loss due to COVID-19 as part of policyholders' business interruption coverage."[5] Similarly, legislation is being introduced in some states (as of this writing, Louisiana, Massachusetts, New Jersey, New York, and Ohio) to compel insurers to cover business interruption claims attributed to COVID-19. The UK Parliament has raised similar questions.[6] The outcomes remain unclear. Even if legislation is successfully passed, this issue will be heavily litigated, raising constitutional-law issues.

COVID-19's impact on business interruption coverage remains highly uncertain—but it clearly represents a reputation risk for P&C insurers, and finding the right balance and approach across all stakeholders will be challenging. After the 2020 policy year resolves, the industry will look to innovate and explore the potential for expanded pandemic-related coverage. Some such products were introduced to the market before the current crisis. For example, the World Bank Pandemic Emergency Financing Facility has various instruments that will trigger based on a predefined number of deaths. Additionally, in private markets, Marsh, Munich Re, and Metabiota introduced a pandemic risk solution using a "pathogenic sentiment index" that triggers under certain thresholds during an epidemic or pandemic. These products, prior to the current crisis, had low adoption. Indeed, pandemic business interruption protection has proven to be a coverage need that was imagined but not appreciated until very recently.

Impact on personal lines

As we've seen in previous recessions, personal lines carriers are less vulnerable than commercial lines carriers to disruption due to COVID-19. But again, the effects will vary by coverage type (Exhibit 3).

Auto: Stalled new business, improved loss ratios in the short term

With one-third of the world's population under stay-at-home orders as of March 25,[7] auto insurance growth will be impacted. New auto policies will slow down as new car purchases decline, while insurance agents may find new business production challenging in a remote environment. In the United States, some carriers are starting to return premiums to customers proactively, reflecting decreased usage.[8] However, with fewer miles driven and fewer cars on the road, frequency rates should decrease considerably, improving loss ratios in the near term.

As with business interruption coverage, personal auto coverage may also be subject to regulatory action. In the United States, the state of Colorado's insurance department has asked insurance companies to temporarily remove the delivery service exclusion, which is common in auto insurance policies, to help restaurants and other services expand delivery while they remain closed to in-person customers.[9]

Home: Stable

As individuals and families spend more time in their homes, homeowner's insurance coverage

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4 "Maryland Insurance Administration advisory on business interruption insurance," Maryland Insurance Administration, March 18, 2020, insurance.maryland.gov.
5 "Members of Congress urge insurers to cover COVID business interruptions," Carrier Management, March 20, 2020, carriermanagement.com.
6 "Insurance industry could be 'in jeopardy' over virus claims, warns Lloyd's chair," *Financial Times*, March 26, 2020, ft.com.
7 "One third of humanity under virus lockdown," AFP News, March 25, 2020, afp.com.
8 Chris Isidore, "Auto insurance companies return $800 million in premiums because no one is driving," CNN, April 6, 2020, cnn.com.
9 "Emergency regulation issued for Colorado automobile insurers," Hall & Evans, March 27, 2020, hallevans.com.

Exhibit 3

The COVID-19 pandemic will have an impact on all personal insurance lines.

↑ Positive ↓ Negative → Stable ? Unknown

	Short- to medium-term implications		
	Premium volume	**Loss ratio deterioration**	**Long-term implications**
Auto	↓ New business and current return of premiums given economic shutdown	↑ Reduced driving (less frequency) in near term ↓ Social inflation, new driving behaviors, more fraud	↑ Faster shift to omnichannel and digital; more digital interactivity with agents/brokers and customers ? New driving patterns—less commuting? Less use of public transportation
Homeowner's	→ Home occupancy unlikely to change	→ Limited change in risk profile of home exposures	
Travel	↓ Interruption of sales with less travel	↓ Pandemics often excluded—but still claims-related activity and some companies waiving the exclusion	? Less need if there is less travel; or more need if pandemics can be included?
Contextual sales (product/delivery insurance)	↑ Increase in online shopping could trigger demand	? Global supply chain disruption impacting online sales?	↑ Higher adoption for platform-based contextual insurance products

will not be affected. McKinsey analysis has shown that personal property insurance levels remain resilient even in times of economic contraction and depressed property values. However, if a large, catastrophic event were to occur, such as an earthquake or heavy flooding, the emergency management response would be more challenging than usual given the extended time required to complete reconstruction while honoring physical distancing requirements.

Niche lines: Travel hit hard, rise in contextual sales coverage

Several of the smaller niche lines will also feel the effects of COVID-19. For instance, travel insurance is likely the hardest hit line in the short term, as existing in-force policies are experiencing a tidal wave of claims. Pandemics are often excluded from coverage, particularly since previous outbreaks such as SARS in 2002.[10] However, some leading companies have made an exception and are waiving this exclusion for those with COVID-19.

Contextual insurance is an emerging product category, particularly in Asia, that protects products purchased online and delivered to a home or business. Adoption of these products outside of Asia has been low, but with the increased shift to online transactions as people work and shop remotely, there could be increased adoption of these coverages in mature markets.

Positioning your organization to navigate this crisis

Navigating these challenges—and repositioning the organization for when the crisis subsides—requires a comprehensive response beyond near-term business-continuity measures. On a positive note, several senior executives, in recent discussions with McKinsey, have mentioned that their organizations have been surprisingly resilient in adapting to current conditions.

As companies continue to navigate this crisis, priority actions include the following:

Build remote-working models. For carriers with significant manual, high-value processes (for example, underwriting and claims), it will be critical

[10] "U.S. coverage alert – 2019 novel coronavirus/COVID-19," Allianz Travel, March 16, 2020, allianztravelinsurance.com.

to maintain oversight, coaching, and collaboration in remote-working environments. This could include establishing virtual dashboards to monitor progress, launching remote team huddles via video conference, and ensuring managers are still coaching and leading their teams despite logistical challenges. It is equally important to prioritize employee morale and both physical and mental health during these turbulent times. In addition, it will be important to roll out performance incentives to ensure world-class decisions and actions that align with a remote-working environment.

Overcommunicate with stakeholders. Acting fast is critical in the current environment. Executives will want to regularly communicate with the board, investors, regulators, and other key stakeholders to promote clarity and syndication regarding the decisions made and actions taken.

Stress-test and develop granular strategies for the portfolio. As discussed above, the effects of the COVID-19 pandemic will be pervasive, however it will have varying impact across segments and coverage types. Comprehensive stress testing will be essential for carriers to rapidly assess exposure across sectors, understand the financial impact, and develop segment-specific responses to meet the needs of customers, agents, and the business. Scenario testing will require organizing a multidisciplinary team across underwriting, claims, actuarial, and risk to anticipate the impact. From a practical perspective, building COVID-19 claims coding into current systems will be crucial to documenting and understanding the pandemic's immediate impact.

Innovate the product portfolio. In the very near term, existing products may need to be repriced (for example, commercial auto policies with decreasing exposure units) and coverage will need to be clarified (for example, whether business interruption includes pandemic-related shutdowns). Over the longer term, this crisis highlights the importance of launching new product offerings (for example, flexible delivery-services coverage for restaurants) and accelerating usage-based offerings (for example, output-based coverage for manufacturing or telematics for auto). In the longer term, the industry will explore expanding business-continuity coverage to directly cover pandemic exposure.

Consider government partnerships for risk management. Pandemics, because they affect so many people and businesses at the same time, are typically considered uninsurable. Insurers and governments could collaborate further on financial protection against this risk. As an analogue, in the aftermath of the September 11th attacks, terrorism risk was viewed as uninsurable by private insurance markets. Since then, many countries around the world have established national insurance programs as partnerships between the insurance industry and the national government to make this risk insurable, particularly for terrorism and natural catastrophe exposures. Similar structures might be explored for pandemic risk.

Gain a deeper understanding of future risk. For coverages that require promotion of safety standards, such as workers' compensation and professional liability, insurance companies will need to update the risk management guidance provided to customers, encouraging them to appropriately plan for pandemic-related risk that may emerge in the future. Customers look to insurance companies to provide guidance on how to best prevent or mitigate future losses.

Invest in distribution agents. Many agents are small business owners themselves, struggling to adjust to remote working models and maintain their own economic activity. Doubling down on partnerships with agents during this time of need will be critical to supporting their operations and building deeper loyalty and trust. This could include expanding offerings from central service centers, providing white-labeled digital interfaces to enable online sales by agents, and providing webinars and training to agents (and customers) on how to navigate the “new normal” of COVID-19 working conditions. Some carriers are also providing short-term cash flow relief to help mitigate the slowdown in new business sales.

Accelerate automation and digital transformation. If ever there was a time when intermediaries and policyholders might be willing to abandon paper and move online, that time is now. This opportunity can represent the tipping point. Carriers can lean in by promoting digital channels for all segments of the value chain, from equipping agents with remote capabilities to driving distinctive customer engagement through digital payments, submissions, and claims. It is also important to acquire and develop the appropriate technical skills to interact with customers on their terms and to meet their evolving needs.

Support customers. The industry has an opportunity to align premium collection with underlying asset usage—for instance, if personal automobiles have lower utilization, insurance companies may return premiums or temporarily reduce rates. Similar concessions may be made for individuals or businesses facing immediate financial duress from the shutdown of economic activity.

In this time of crisis, P&C carriers should focus on their employees, their customers, and their business—in that order.[11] Insurance companies provide crucial stability to the economy and to their customers both personally and professionally. They provide value through the promise to pay future claims, so the industry must calibrate its pricing and coverage to ensure its viability in light of this crisis. More than ever, this is also a time for insurance companies to provide customers with the empathy and support they need.

[11] Kevin Sneader, “Kevin Sneader: We’re not going back to the ‘normal’ we had before coronavirus,” March 26, 2020, McKinsey.com.

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