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PANDEMIC RISK

Lessons learned

Conclusions can be drawn from the last two years that can help reduce protection gaps and boost resilience

COVID-19 caught the entire world by surprise, even though there have been pandemics in the past and the potential of a pandemic occurring was known and widely documented.

Building future resilience and preparedness requires societies to spend more time anticipating and preparing for events that could happen. It is important not only to prepare for "grey swans" — risks that are rare but well-recognised, like a pandemic — but also "black swans" — rare and highly unexpected events with a potentially major impact, such as the 11 September 2001 terrorist attacks in the USA.

Since it appeared, the COVID-19 pandemic has not only cost many lives and created immense economic hardship for many people and businesses around the world, but it has also been an extremely challenging period for insurers and their customers. Indeed, 2020 was unprecedented, with insurers' business flows, claims and assets all hit by the pandemic. Thankfully, 2021 saw a gradual return to normality.

Insurability questions

COVID-19 raised many questions about the insurability of pandemic risk and also about the preparedness of societies for such widely anticipated but rare events (see box on p44).

Important lessons can consequently be drawn from the last two years, lessons that are not only crucial in boosting pandemic preparedness, but that are also invaluable for reducing protection gaps and increasing resilience in other potentially systemically risky areas, such as cyber, or in the context of climate change. While there are big differences between a pandemic, a cyber attack and a climate change-related event, the COVID-19 pandemic reinforced the importance of making further progress in four key areas: prevention, public-private partnerships, data, and the clarity and understanding of policy wordings.

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Prevention is better than cure

A risk can only be insured if the potential claim associated with it remains within certain limits and can be estimated. If these conditions are not easily met, prevention must play an even more important role. Indeed, whether it is refraining from building in areas exposed to natural risks or raising awareness to reduce cyber-risk exposure, prevention can actually help to render certain risks insurable and enable insurers to expand the cover they are able to provide.

Of course, prevention is not a silver bullet. In the case of pandemics, for instance, which have the potential to affect pretty much everyone anywhere in the world and a large range of economic sectors all at the same time, it is doubtful whether risk-reduction measures could ultimately lead to the risk becoming insurable. This is particularly true for the risk of business interruption. Nevertheless, there are measures that can be taken to make societies more resilient, such as investing in health infrastructures and ensuring the availability of protective equipment and sufficient testing capacity.

Prevention measures and policies that are risk-averse are versatile and depend on the type of risk. And while prevention measures are crucial for insurers to be able to provide cover for certain risks and insurers play an important role in providing prevention advice, the implementation of these measures generally falls to public authorities and usually requires the involvement of many other stakeholders as well. Insurers are keen to take a proactive part in these discussions, whatever the type of risk under consideration.

Working together

Public-private partnerships (PPPs) have proved to be highly effective instruments in dealing with many risks, allowing the public and private sectors to share and capitalise on available resources, know-how and risk-management experience.

Insurers across Europe have a great deal of experience in collaborating with public authorities through dedicated PPPs, most notably for climate-change-related risks. Insurers have the capacity to withstand hugely damaging events, vast knowledge of risk-modelling and large amounts of data, and these types of collaborations allow insurers to share their knowledge and expertise with policymakers and other key sectors.

A Spanish PPP, which dates back to 1941 and which is managed by the Consorcio de Compensación de Seguros (CCS), is a prime example. A large proportion of natcat perils are covered by the CCS and the system provides for a state guarantee to absorb losses that are too big for the CCS to handle. However, there is no one-size-fits-all PPP solution, particularly in the natcat area, because countries are exposed to different risks and have different traditions or levels of insurance penetration. This is why PPPs need to be tailored to local realities.

EIOPA's work on shared resilience solutions

In the wake of the COVID-19 pandemic, Insurance Europe took part in a workstream set up by EIOPA that focused on exploring the possibility of shared resilience solutions.

This work resulted in a staff paper on measures to improve the insurability of business interruption risk in pandemics[1], which underscores the importance of prevention, the added value of multi-peril solutions and the possibility of capital markets serving as an additional layer of risk diversification. So far, this has not led to any concrete follow-up action, either at EU or at national level.

1 Staff paper on measures to improve the insurability of business interruption risk in light of pandemics, EIOPA, February 2021

Joining forces could also be considered for risks that have the potential to become systemic, such as cyber risk. Given the evolving nature of cyber risk, it is vital to maintain a dialogue between all interested parties, and the insurance industry is a proactive instigator of and participant in all debates around boosting preparedness and resilience.

Insurers have also taken an active role in the discussions at EU level and in a number of countries on a possible cooperation between the public and private sectors to cover pandemic risks but, so far, no solution has been identified.

Facts and figures

One way to help make a risk that is difficult to insure more insurable is by increasing the amount of available data, as by better understanding risks insurers are more likely to be able to cover them.

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This is notably the case in the cyber area, where lack of data is considered one of the main barriers to insurers offering cover. (For more on this issue, see the cyber risks article on p35).

Recently adopted EU legislation, such as the General Data Protection Regulation or the Network and Information Security Directive, or legislation currently being adopted, such as the Digital Operational Resilience Act, offer an opportunity to improve insurers' underwriting, as they will generate a wealth of new data. This explains why insurers are engaging with supervisory authorities to identify the conditions under which they could get access to anonymised, aggregate sets of the data generated.

This is also true in the climate area, as data is key to boosting efforts in support of adaptation and mitigation. Natcat is an area in which many insurers are already sharing data through national or local PPPs and there are numerous examples of how data-sharing, as well as the dissemination of public and private data and indicators related to natural hazards, allowed for improved risk analysis, prevention and risk management.

For instance, through a pilot PPP, Norwegian insurers shared asset-level loss data with nine municipalities. By coupling information on extreme rainfall and storms to insurers' data on the location of insurance claims, these municipalities were able to adopt a more evidence-based approach to climate adaptation.

Another example of effective data-sharing is the French National Observatory for Natural Hazards (ONRN), a platform through which public and private data and indicators related to natural hazards can be shared and disseminated, and which allows for more effective risk management and prevention. Insurance Europe's Sustainability Hub showcases many more examples of insurers' initiatives to expand the limits of insurability and absorb more risks.

The availability of data does not, however, mean that any risk can be covered or can be covered at an affordable price. In the case of pandemic risk, for instance, the difficulty is not that the risk itself cannot be modelled, but rather that resulting government actions cannot and, in areas such as business interruption, much of the risk depends on those actions.

Cover over cost

A focus on what an insurance product covers, as opposed to an almost exclusive focus on what it costs, is already becoming more prominent in all areas. In the wake of the COVID-19 pandemic, policyholders are likely to pay increasing attention to exactly what their policies cover.

If anything, COVID-19 and its effects demonstrated the significance of the provision of information to policyholders—on how insurance works, what a product covers and does not cover, and what the terms and conditions, including exclusions, of policies entail. Insurers have consequently reinforced their focus on addressing any potential misunderstandings between policyholders and the industry.

Tackling this challenge, however, requires more work, including an ongoing dialogue between the industry, customers, supervisors and regulators, first of all to reduce regulatory obstacles so that insurers can provide the necessary clarity, but also to ensure that customers do not solely focus on price and cost comparisons when deciding on their insurance products. (For more on this issue, see the retail investment article on p27.)