Pandemics, Politics & Economics:
P/C Insurance in an Era of Uncertainty

Target Markets
2020 Summit Week
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Pandemics & P/C Insurance: Outline

- **P/C Insurers: Overcoming Uncertainty With Strength**
  - Financial Overview: The Industry's Financial Position Amid the COVID-19 Pandemic
- **COVID-19: Potential Coronavirus Impacts on Key Lines**
- **Investment Market Issues: Volatility Rules, Low Interest Rates are Back**
- **The Economy and COVID-19: Overview & Outlook**
- **Commercial Lines Rate Trends & Reinsurance Market Developments**
- **Litigation/Tort Trends**
- **Federal & State COVID-19 Initiatives Impacting Commercial Insurers**
- **Summary, Conclusions and Q&A**

P/C Insurance Industry: Financial Overview Amid the COVID-19 Pandemic

The P/C Insurance Industry Entered the COVID-19 Pandemic from a Position of Financial Strength

Economic, Financial Market, Regulatory and Tort Risks Are Major Challenges Going Forward

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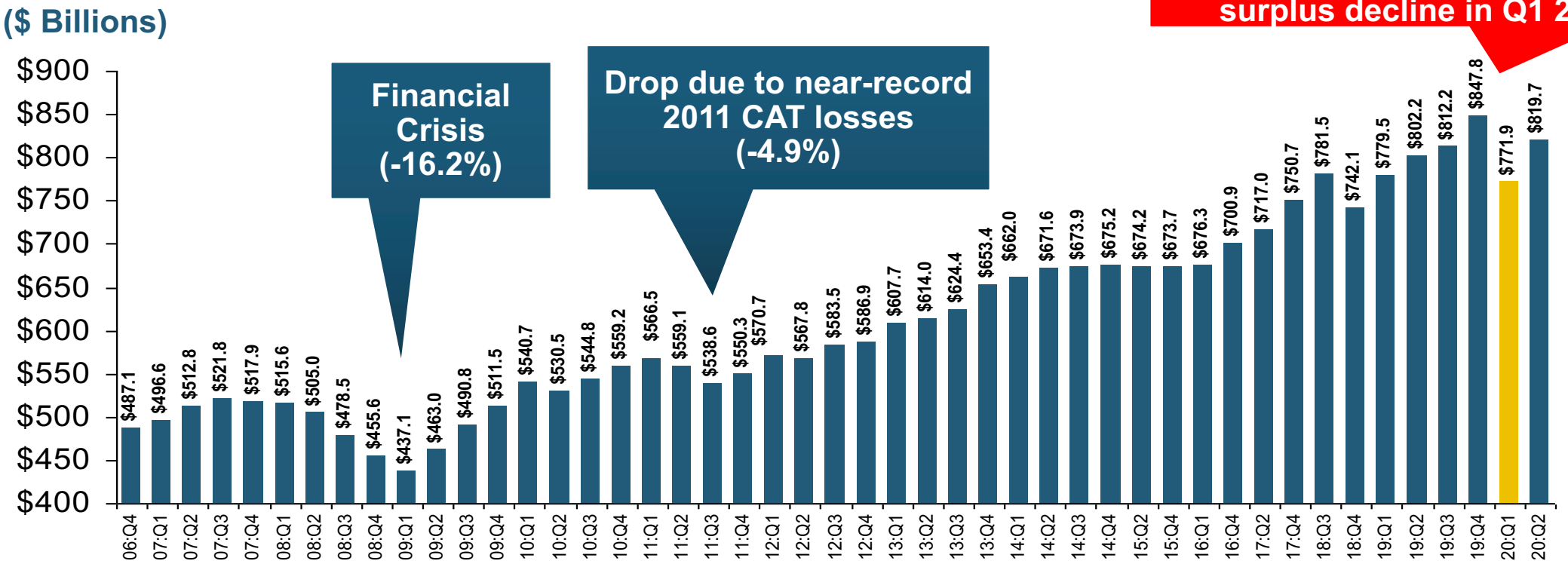
Policyholder Surplus (Capacity), 2006:Q4–2020:H1

The P/C insurance industry entered the COVID-19 pandemic from a position strength and was able to withstand the 9.0% surplus decline in Q1 2020

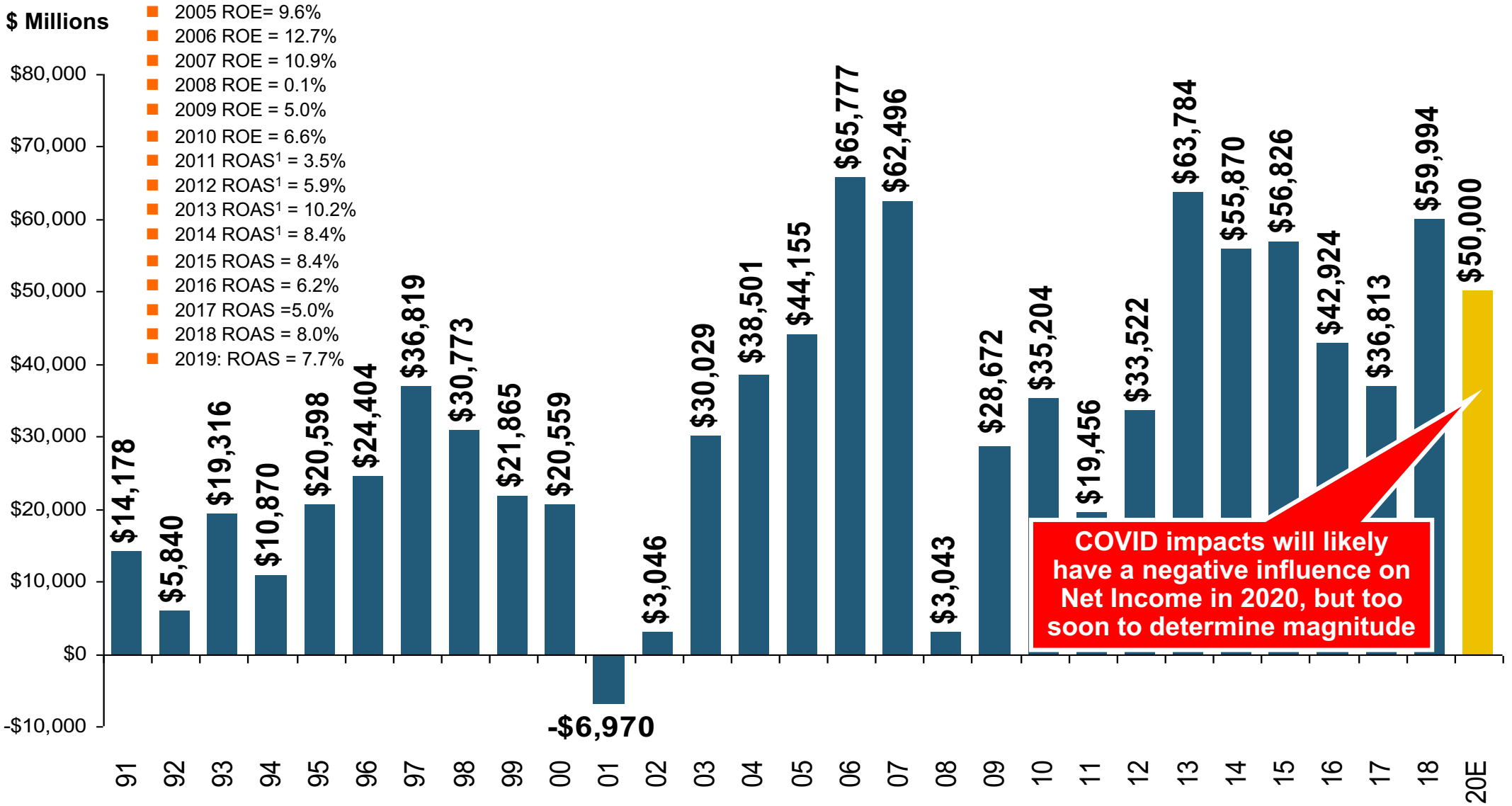


2010:Q1 data includes $22.5B of paid-in capital from a holding company parent for one insurer's investment in a non-insurance business.

Policyholder Surplus is the industry's financial cushion against large insured events, periods of economic stress and financial market volatility. It is also a source of capital to underwrite new risks.

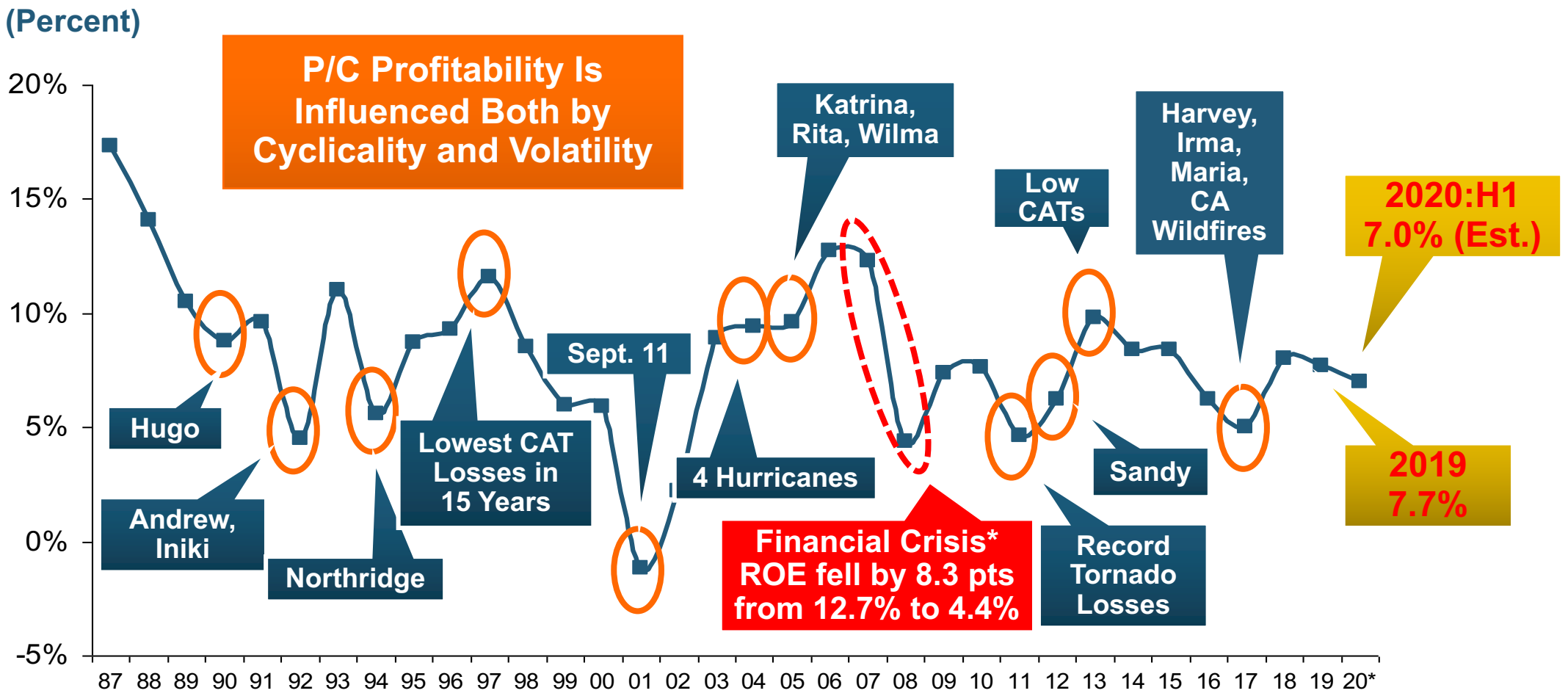
Sources: ISO, A.M .Best; Risk and Uncertainty Management Center, University of South Carolina.

P/C Industry Net Income After Taxes, 1991–2020E*



*2020 estimate based on annualized actual 1H:20 figure of $25.0B. ROE figures are GAAP; [1]Return on avg. surplus. Excludes Mortgage & Financial Guaranty insurers for years (2009-2014).
Sources: A.M. Best, ISO.

ROE: Property/Casualty Insurance by Major Event, 1987–2020:H1* (est.)

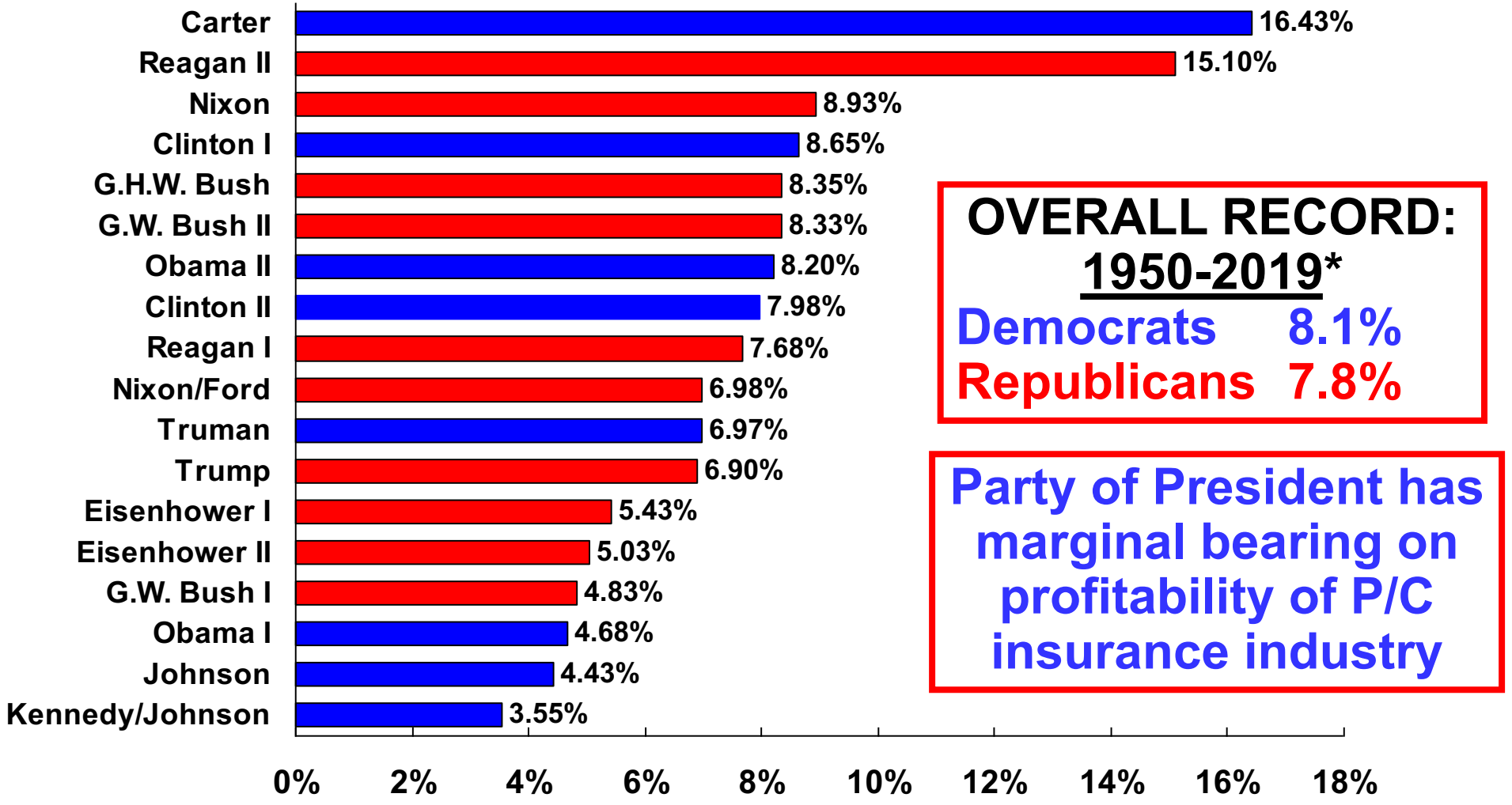


*Excludes Mortgage & Financial Guarantee in 2008 – 2014. 2020:H1 estimate is based on actual Q1 2020 figure of 8.8%.
Sources: ISO, *Fortune*; USC RUM Center.

Profitability & Politics

How Is Profitability Affected by the President's Political Party?

P/C Insurance Industry ROE by Presidential Administration, 1950-2019*

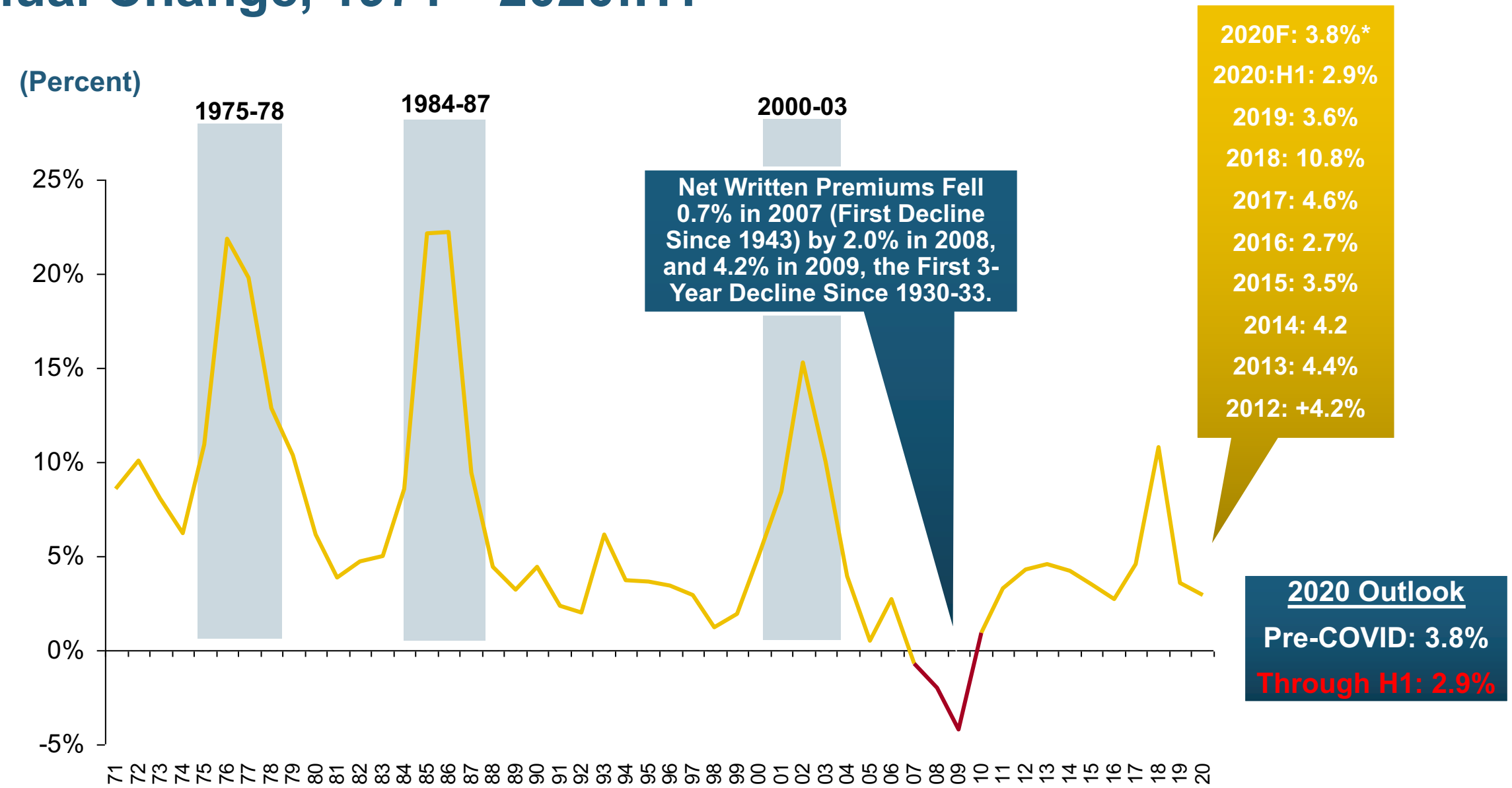


OVERALL RECORD:
1950-2019*
Democrats 8.1%
Republicans 7.8%

Party of President has marginal bearing on profitability of P/C insurance industry

*Trump figure is 2017-2019 average. ROEs for the years 2008-2014 exclude mortgage and financial guaranty segments.
Source: Risk and Uncertainty Management Center, University of South Carolina.

Net Premium Growth (All P/C Lines): Annual Change, 1971—2020:H1



*Pre-COVID-19 forecast from A.M. Best Review & Preview (Feb. 2020). NOTE: Shaded areas denote "hard market" periods
Sources: A.M. Best (1971-2013, 2020F), ISO (2014-19); Risk & Uncertainty Management Center, Univ. of South Carolina .

Potential Impacts of COVID-19 on *Written Premium* in 2020, by Key Line

Line	Estimated Premium Impact
Workers Compensation	12.5% to 25% reduction in premium written in 2020 ***(equates to $5.9B to $11.75B DWP)***
Business Interruption & Contingency	7% to 13% reduction in premium volume (US & UK)
General Liability*	$1.5B to $6.3B premium reduction in US
Personal Auto	~$10B in refunds, rebates (equates to ~4% of DWP)
Personal Travel Insurance	29% to 78% reduction in premium written (US & UK)
Personal/Comm. Motor	~10% reduction in US; 0% to 11% reduction in UK
Marine/Aviation/Transport	$0.7B-$1.5B (US); $0.6 - $1.2B (UK)

*Includes nursing home professional liability.

Source: Derived from Willis Towers Watson, *Scenario Analysis of COVID-19 Pandemic* (Fig.11, 14), May 2020. and other sources; Risk and Uncertainty Management Center, University of South Carolina.

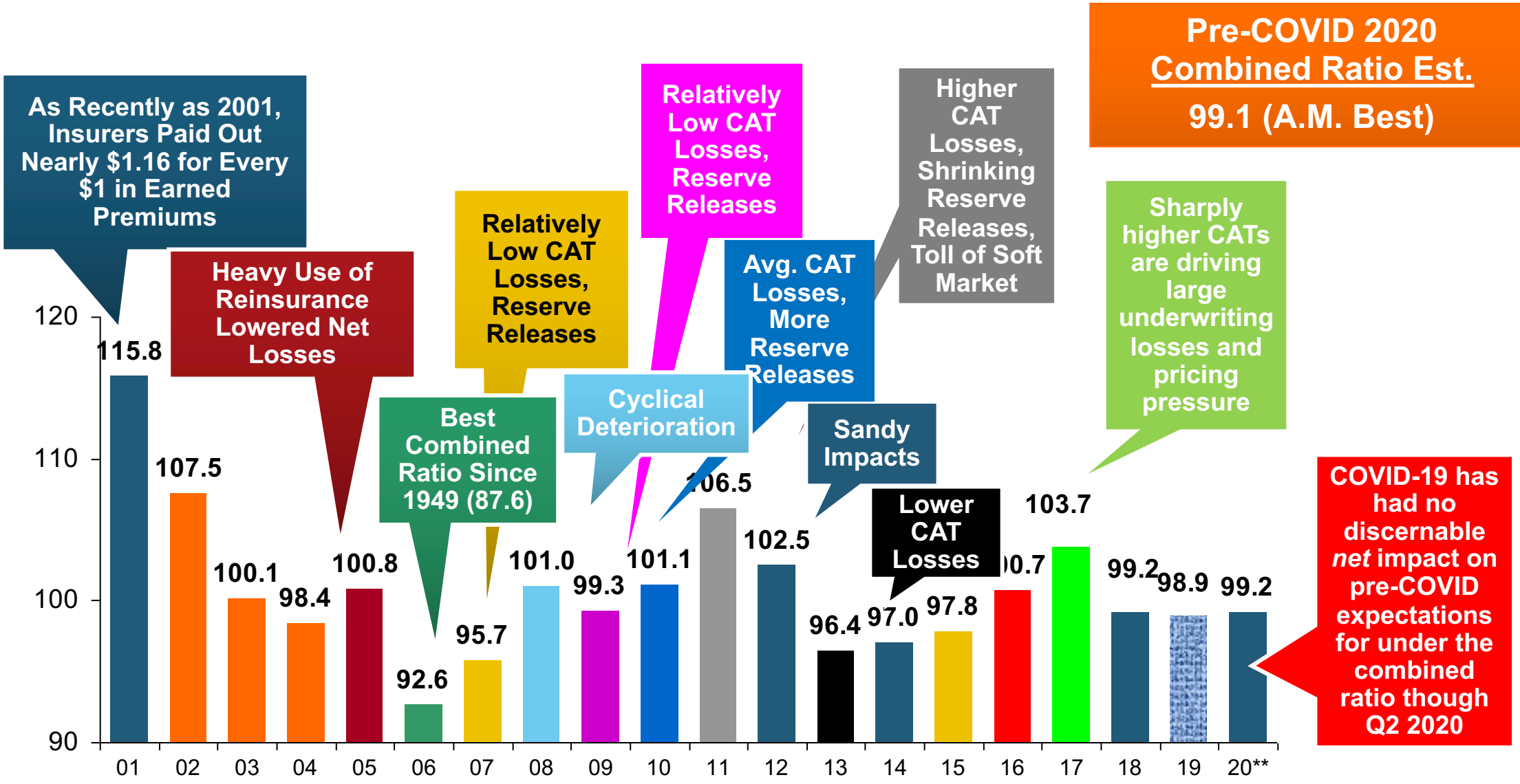
Potential Impacts of COVID-19 on *LOSSES* in 2020, by Key Line

Line	Estimated Loss Impact
Workers Compensation	$0.2B - $92B ***(depends on severity of pandemic and "presumption" determination)***
Business Interruption & Contingency	$2B - $22B (US); $1.1B - $13.9B (UK)
General Liability*	$0.7B to $27B loss across US & Bermuda markets
Personal/Comm. Motor	$26B - $57B reduction in personal auto and $4.2B - $9.4B commercial (US); $1 - $7B overall reduction in UK
Mortgage	$0 - $1.7B loss across US & Bermuda markets
D&O	$0.6 - $4.0 loss across US & Bermuda markets
Marine/Aviation/Transport	$0.3B-$1.3B reduction (US); $0.6 - $1.1B (UK)

*Includes nursing home professional liability.

Source: Derived from Willis Towers Watson, *Scenario Analysis of COVID-19 Pandemic* (Fig.11, 14), May 2020. and other sources; Risk and Uncertainty Management Center, University of South Carolina.

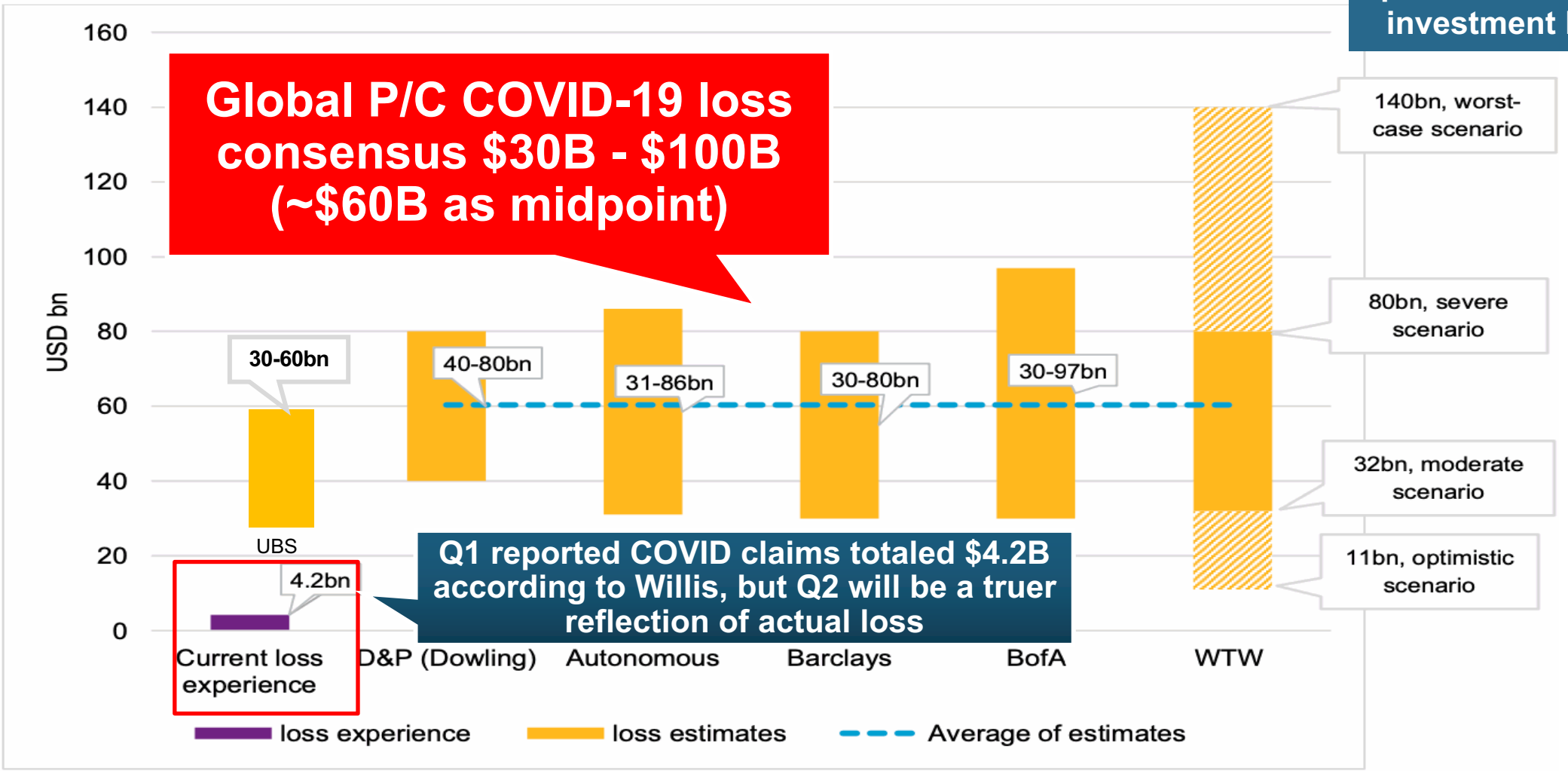
P/C Insurance Industry Combined Ratio, 2001–2020:H1*



*Excludes Mortgage & Financial Guaranty insurers 2008--2014.
*First Half 2020.
Sources: A.M. Best, ISO (2014-2019).

COVID-19 Announced Losses vs. Top-Down Industry Estimates (as of May 12, 2020)

Lloyd's: Says its own p/c claims could reach $4.3B by June 30. Estimates global p/c losses at $107B; Global investment losses = $96B*



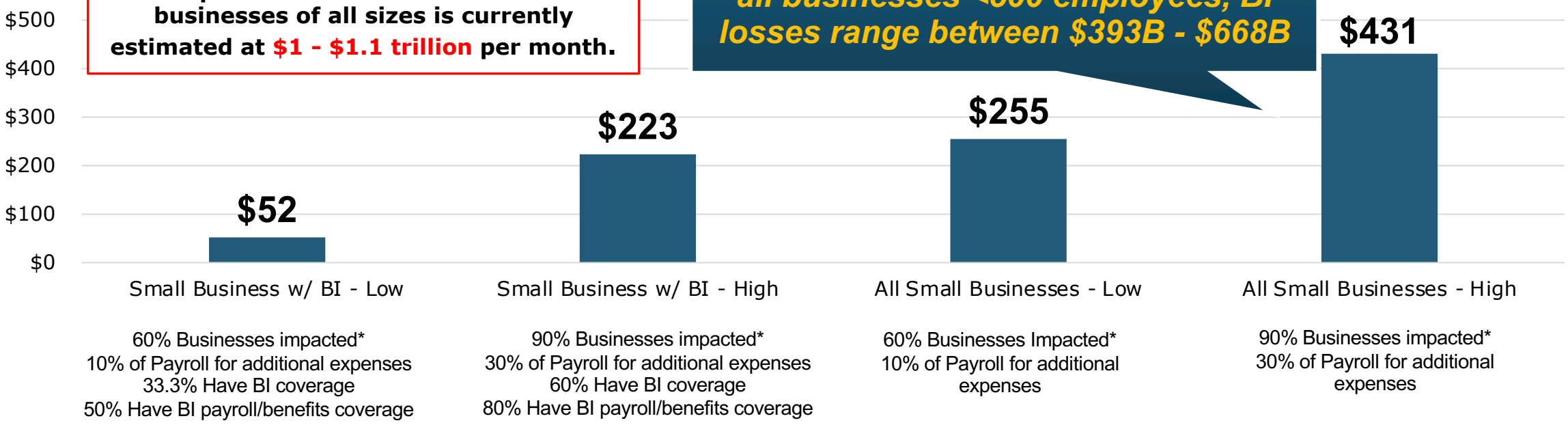
*Lloyd's CEO John Neil appearance on CNBC, May 14, 2020: https://www.cnbc.com/2020/05/14/lloyds-of-london-coronavirus-will-be-largest-loss-on-record-for-insurers.html

Sources: Company disclosures, Dowling & Partners, Barclays Research, Autonomous Research, BofA Global Research, UBS Securities, Willis Towers Watson from Artemis.bm accessed at https://www.artemis.bm/news/consensus-emerging-on-30bn-to-100bn-covid-19-industry-loss-willis-re/; Risk and Uncertainty Management Center, University of South Carolina.

Estimated Monthly U.S. Business Interruption Coronavirus Losses for Small Business—Potential Range (<100 Employees; $Bill)

The potential for such losses for all businesses of all sizes is currently estimated at $1 - $1.1 trillion per month.

Monthly BI losses for small business vary widely depending on underlying assumptions but expansive legislation would result in higher estimates; *For all businesses <500 employees, BI losses range between $393B - $668B*

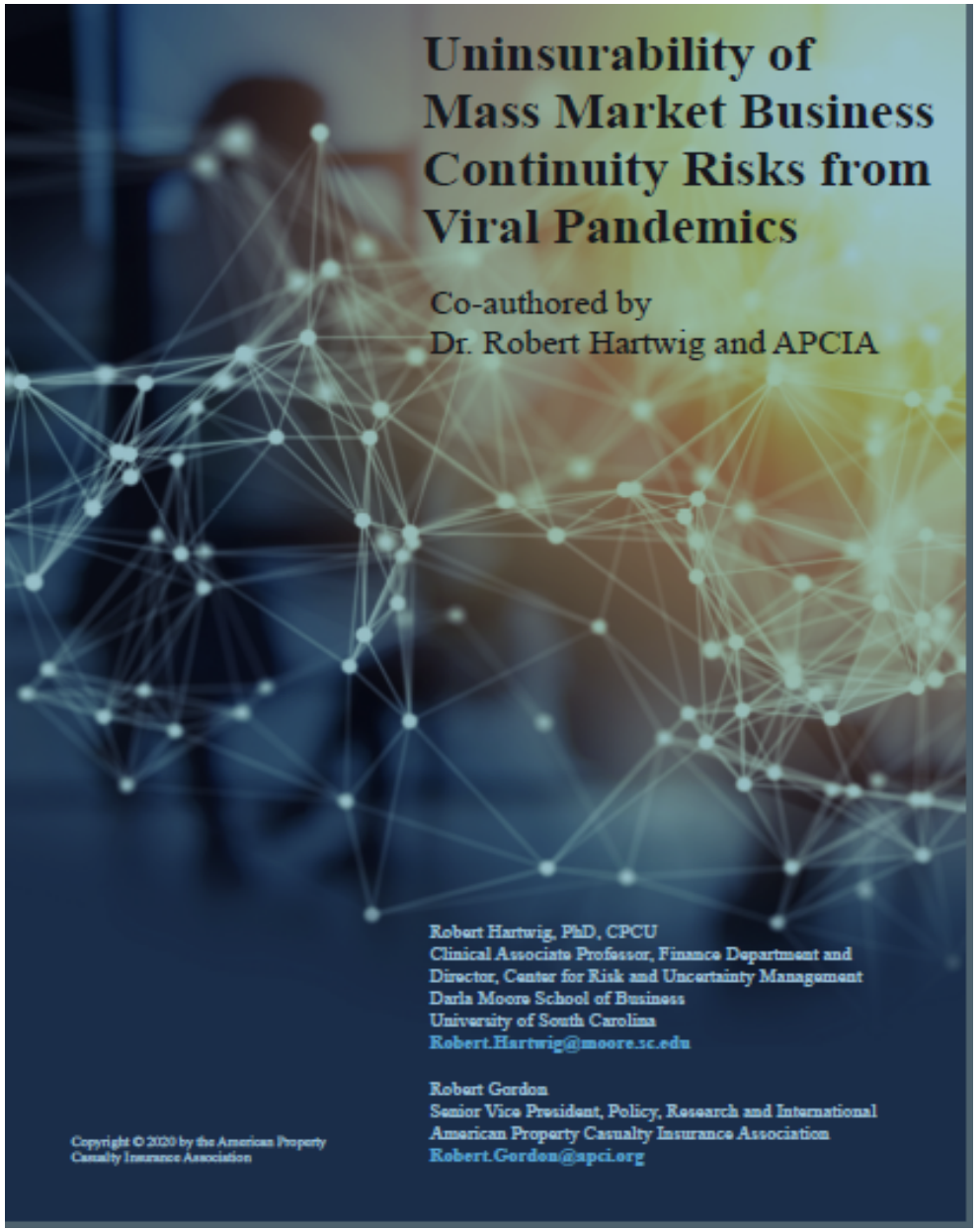


* Businesses impacted: Proportion of businesses completely or substantially closed related to coronavirus
Assumptions: Losses if standard insurance policy exclusions for viruses/pandemics are voided and physical loss/damage requirement is stricken; three main coverages - profit lost, payroll/benefits, additional expenses; average annual $2m revenue and 7% profit margin; non-wage benefits of small businesses are 25% less than that for average US businesses

Source: APCIA, April 2020.

Paper on Insurability of Pandemic Risk

- Large scale business continuity risks from pandemics are generally note insurable in the private sector
- Business continuity risks are largely undiversifiable within private insurance markets and are highly correlated with other risks (e.g., investment risks)
- Large scale business continuity losses pose a potentially systemic risk to the industry and overall economy
- Import role for government



Download at: https://www.uscriskcenter.com/wp-content/uploads/2020/05/Uninsurability-of-Pandemic-Risk-White-Paper-Hartwig-APCIA-FINAL-WORD.pdf

Catastrophe Loss Update: *Major Driver of Rate Pressure*

CAT Losses for the Decade Just Ended Were Up Materially—Costliest Ever

Primary, Reinsurance and Retro Markets All Impacted and Are Pressuring Rates

COVID Pressure Kicks Off the New Decade

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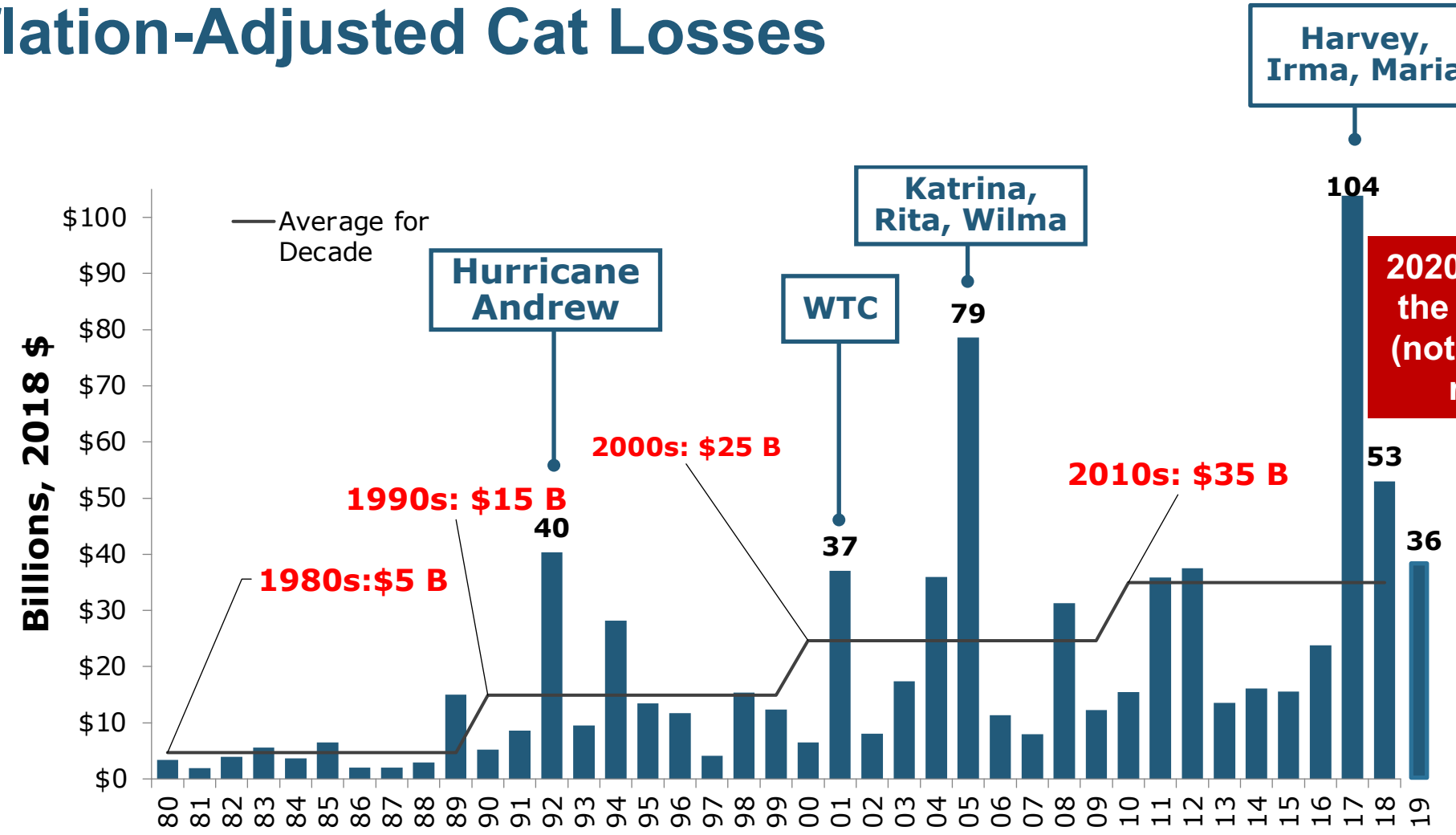
U.S. Inflation-Adjusted Cat Losses



2020:H1 CAT losses in the US totaled ~$20B (not including COVID-related losses)

As of Oct. 4, 2020, more than 4 million acres of woodland had been destroyed by wildfire in CA alone this year

Average Insured Loss per Year for 1980-2019 is $19.8 Billion

Sources: Property Claims Service, a Verisk Analytics business; Insurance Information Institute.

Top 20 Most Costly Disasters in U.S. History—Katrina Still Ranks #1

COVID-19 insured property losses remain highly uncertain, but could easily make the top 10

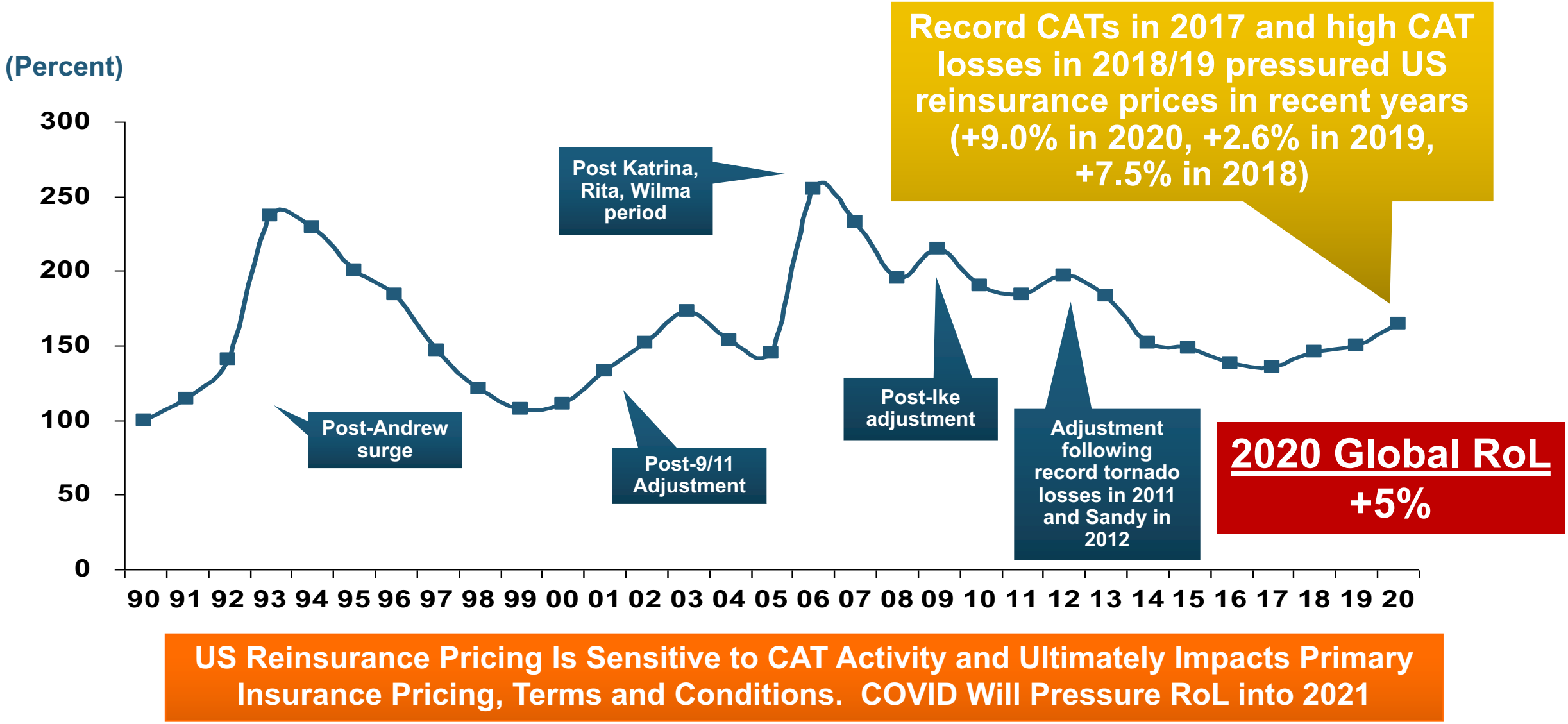
(Insured Losses, 2017 Dollars, $ Billions)*

17 of the 20 Most Expensive Insurance Events in US History Have Occurred Since 2004

*Estimated.

Sources: PCS, RMS, Karen Clark & Co; USC Center for Risk and Uncertainty Management adjustments to 2017 dollars using the CPI.

US Property Catastrophe Rate-on-Line Index: 1990 – 2020*



US Reinsurance Pricing Is Sensitive to CAT Activity and Ultimately Impacts Primary Insurance Pricing, Terms and Conditions. COVID Will Pressure RoL into 2021

*As of January 1 each year.

Source: Guy Carpenter; Artimes.bm accessed at: http://www.artemis.bm/us-property-cat-rate-on-line-index

INVESTMENTS:
THE NEW REALITY

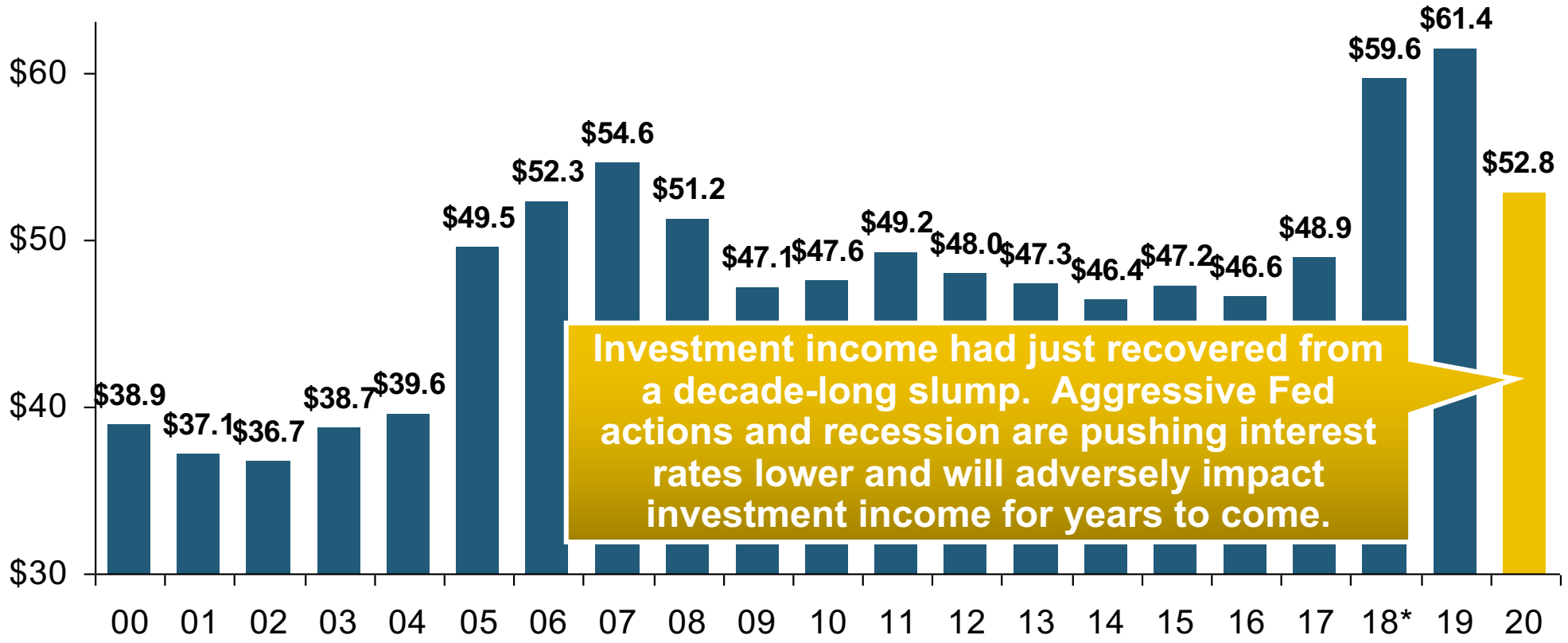
Investment Performance Is a Key Driver of Insurer Profitability

Aggressive Rate Cuts Will Adversely Impact Invest Earnings

Financial Crisis *Déjà Vu*?

Property/Casualty Insurance Industry Investment Income: 2000–2020E

($ Billions)

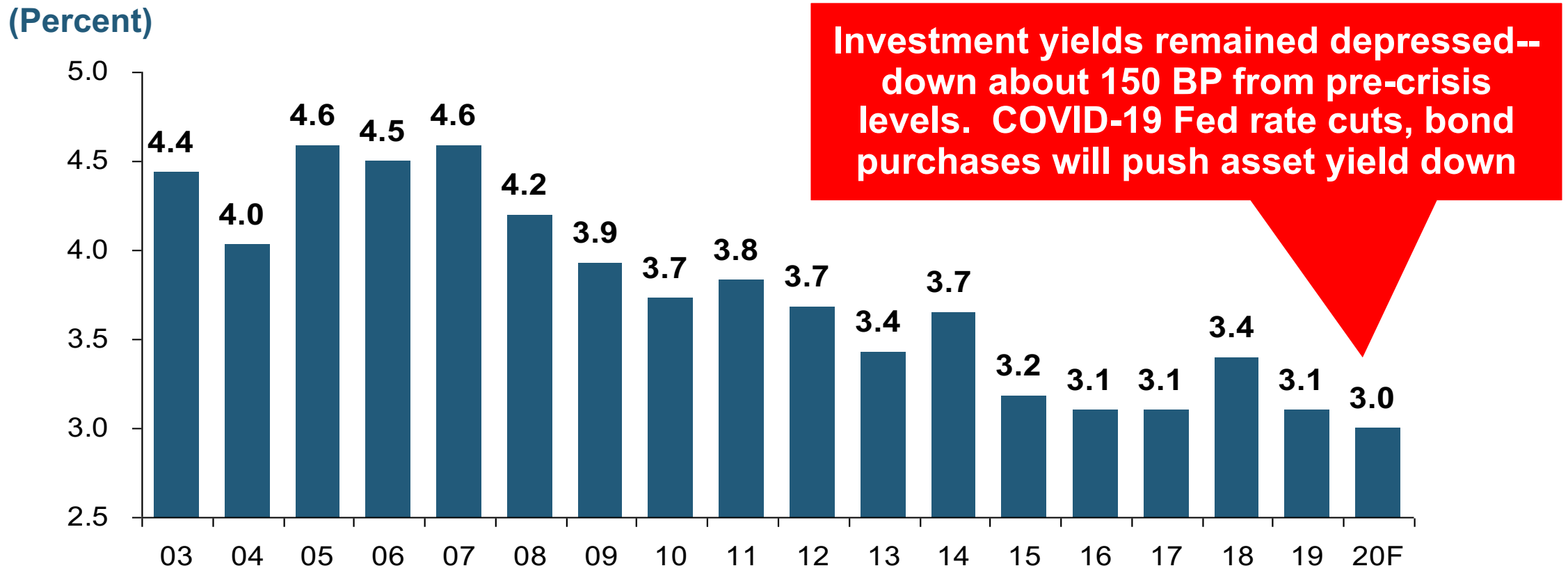


Due to persistently low interest rates, investment income remained below pre-crisis levels for a decade. Lower interest rates post-COVID will drive investment income down once again.

*2020 figure is annualized based on H1 actual of $26.4B. 2018-19 figures are distorted by provisions of the TCJA of 2017. Increase reflects such items as dividends from foreign subsidiaries.

[1] Investment gains consist primarily of interest and stock dividends. Sources: ISO; University of South Carolina, Center for Risk and Uncertainty Management.

Net Investment Yield on Property/Casualty Insurance Invested Assets, 2007–2020F*



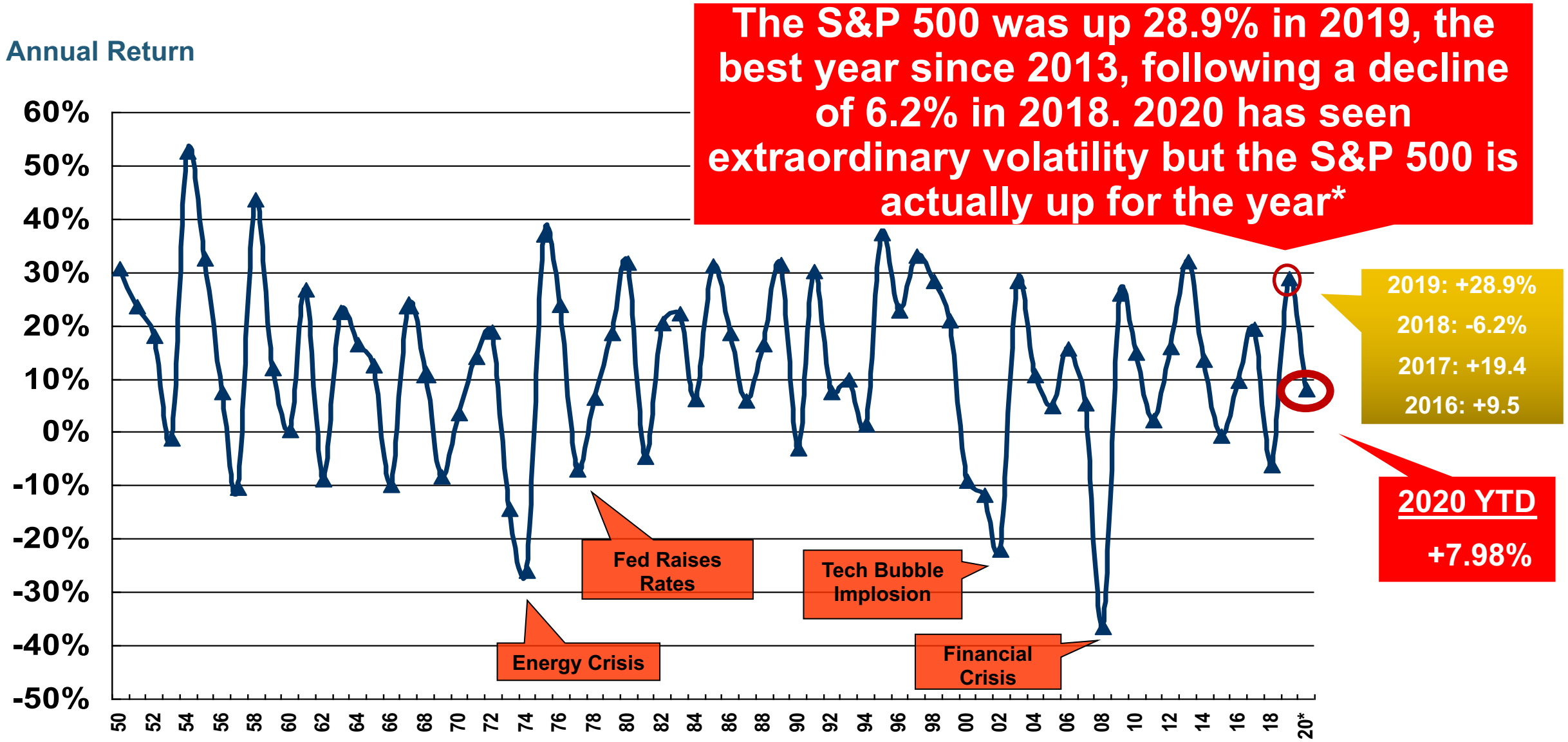
Investment yields remained depressed--down about 150 BP from pre-crisis levels. COVID-19 Fed rate cuts, bond purchases will push asset yield down

The yield on invested assets remains low relative to pre-crisis yields. Fed rate increases beginning in late 2015 through 2018 halted the slide in yields, but rate cuts in 2019/2020 will preclude future gains

Average: 1960-2019 = 4.9%
Low: 2.8% (1961)
High: 8.2% (1984/85)

Sources: NAIC data, sourced from S&P Global Market Intelligence; 2017-19 figures are from ISO. 2020F is from the Risk and Uncertainty Management Center, Univ. of South Carolina.

S&P 500 Index Returns, 1950–2020*



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*Through Oct. 14, 2020.
Source: NYU Stern School of Business: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html; Center for Risk and Uncertainty Management, University of South Carolina

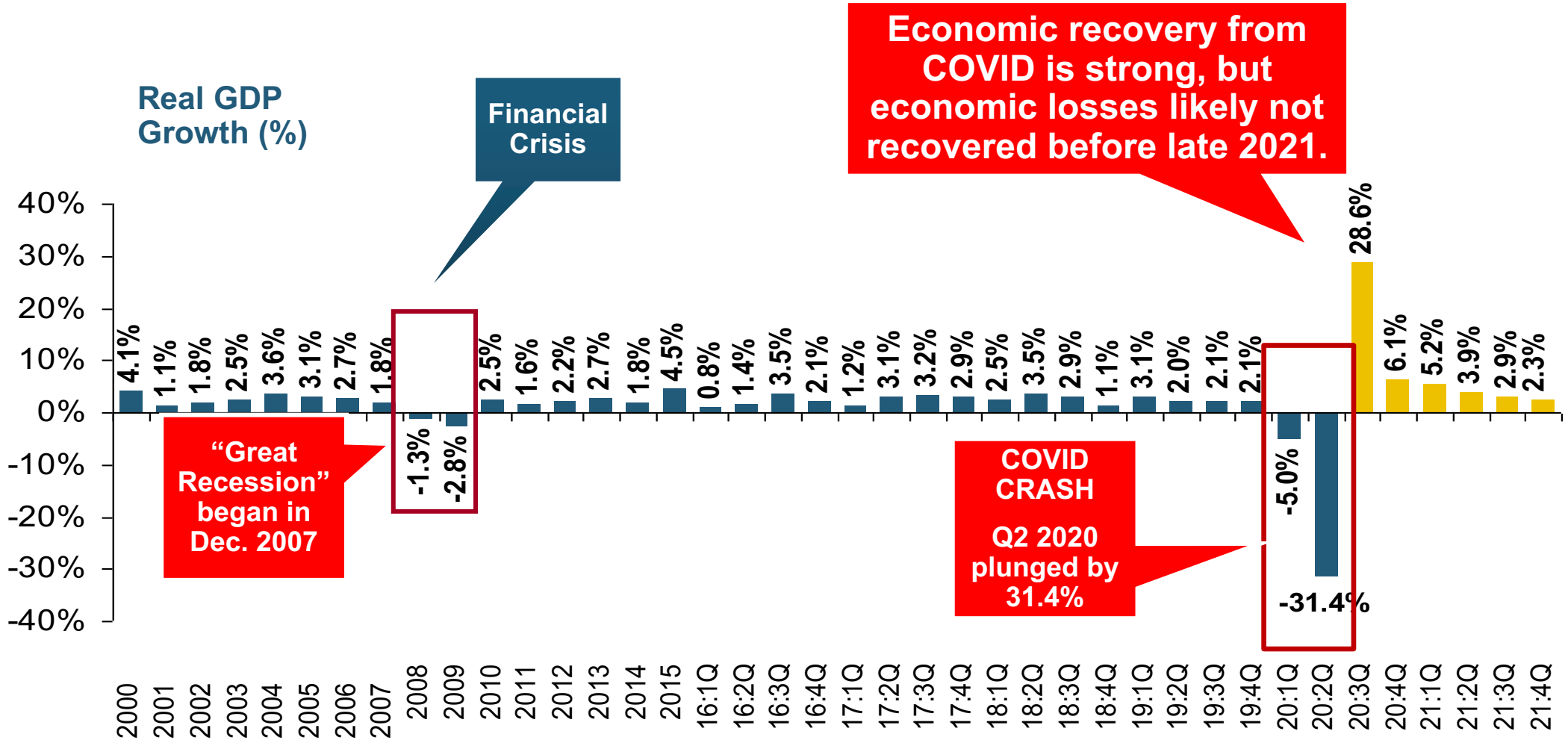
THE ECONOMY

COVID-19 Pandemic Will Directly and Severely Impact Growth As Exposure Growth Rapidly Shrinks

The Strength of the Economy Has Always Influenced Growth in Insurers' Exposure Base Across Most Lines

The Links Between the Economy and the P/C Insurance Industry Are Strengthening

US Real GDP Growth*



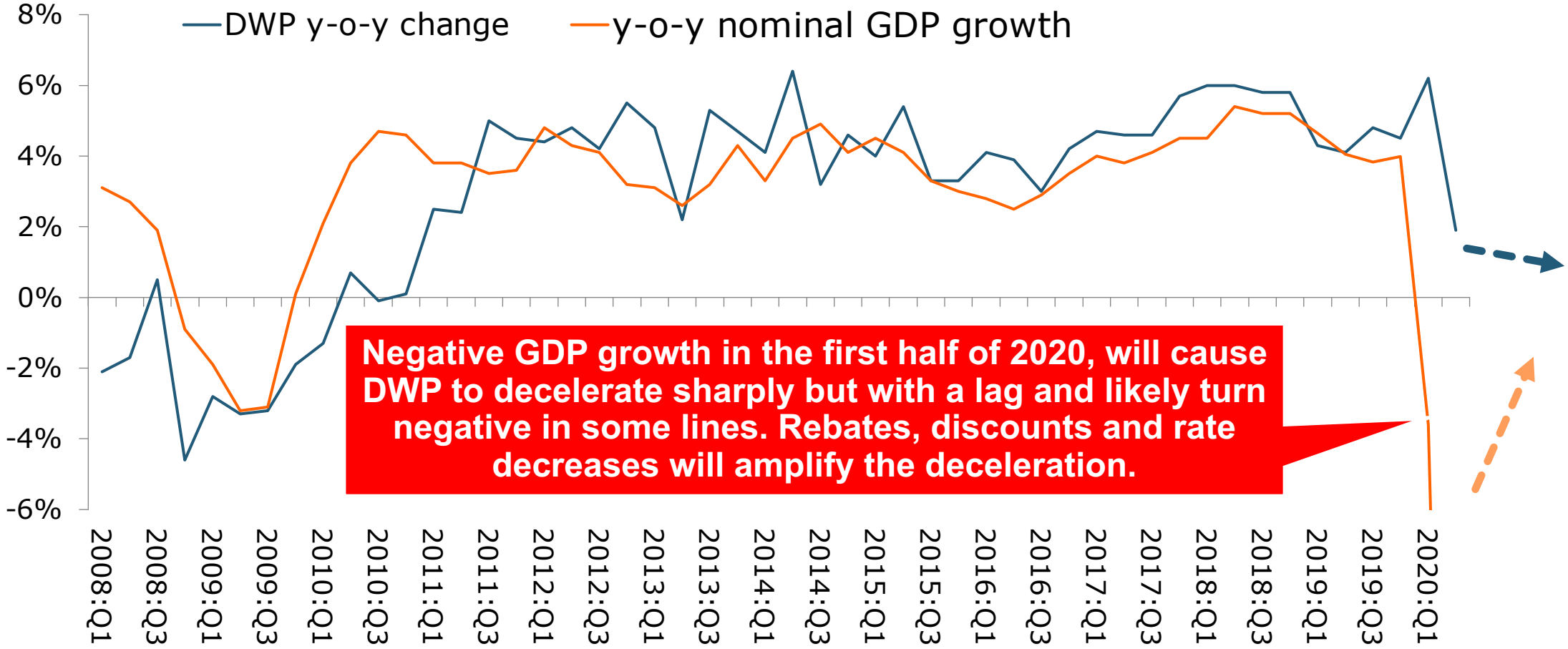
Demand for Insurance Will Be Severely Impacted As the Economy Slows but Is Expected to Improve by Late Q3 and into Q4

* Estimates/Forecasts from Wells Fargo Securities.

Source: US Department of Commerce, Wells Fargo Securities 10/20; Center for Risk and Uncertainty Management, University of South Carolina.

The Economy Drives P/C Insurance Industry Premiums: 2006:Q1–2020:Q2*

Direct Premium Growth (All P/C Lines) vs. Nominal GDP: Quarterly Y-o-Y Pct. Change



Negative GDP growth in the first half of 2020, will cause DWP to decelerate sharply but with a lag and likely turn negative in some lines. Rebates, discounts and rate decreases will amplify the deceleration.

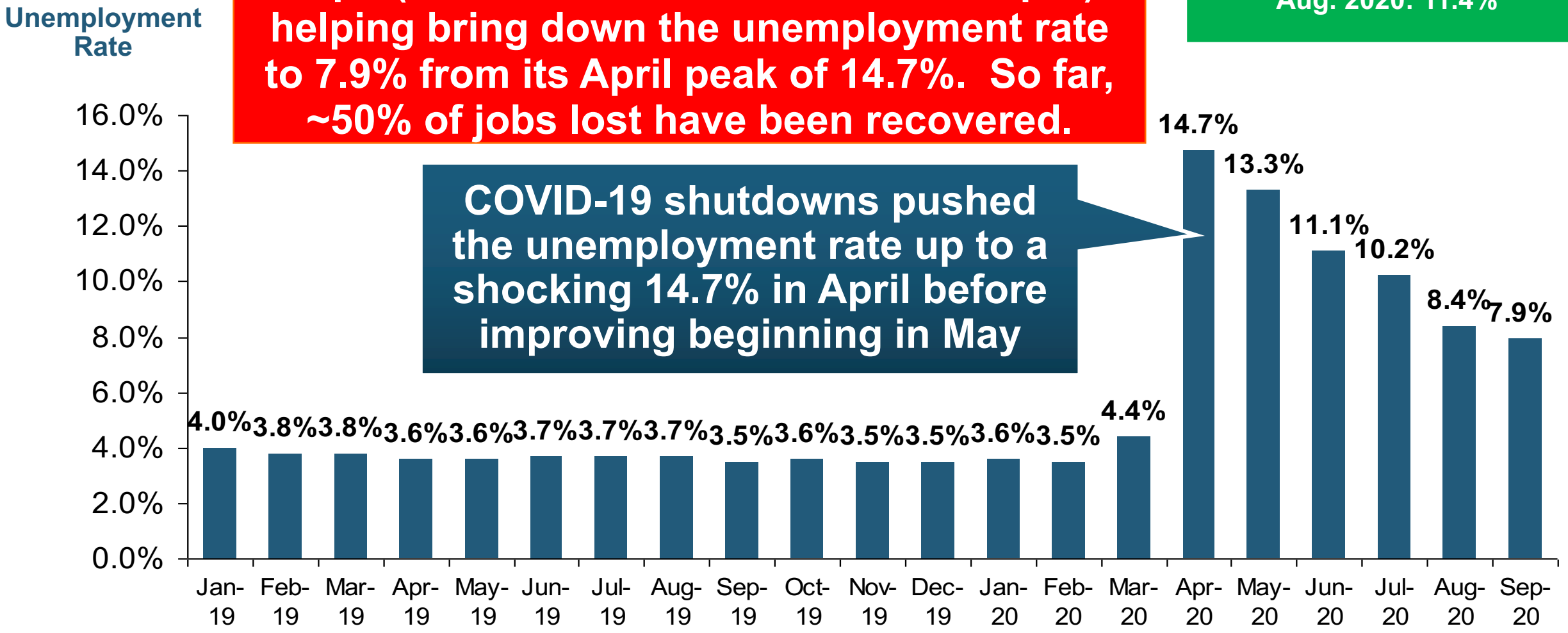
Direct written premiums track nominal GDP fairly tightly over time, suggesting the P/C insurance industry's growth prospects inextricably linked to economic performance.

Sources: SNL Financial; U.S. Commerce Dept., Bureau of Economic Analysis; ISO; I.I.I.; Risk and Uncertainty Management Center, University of South Carolina.

Unemployment Rate: Jan. 2019 – Sept. 2020

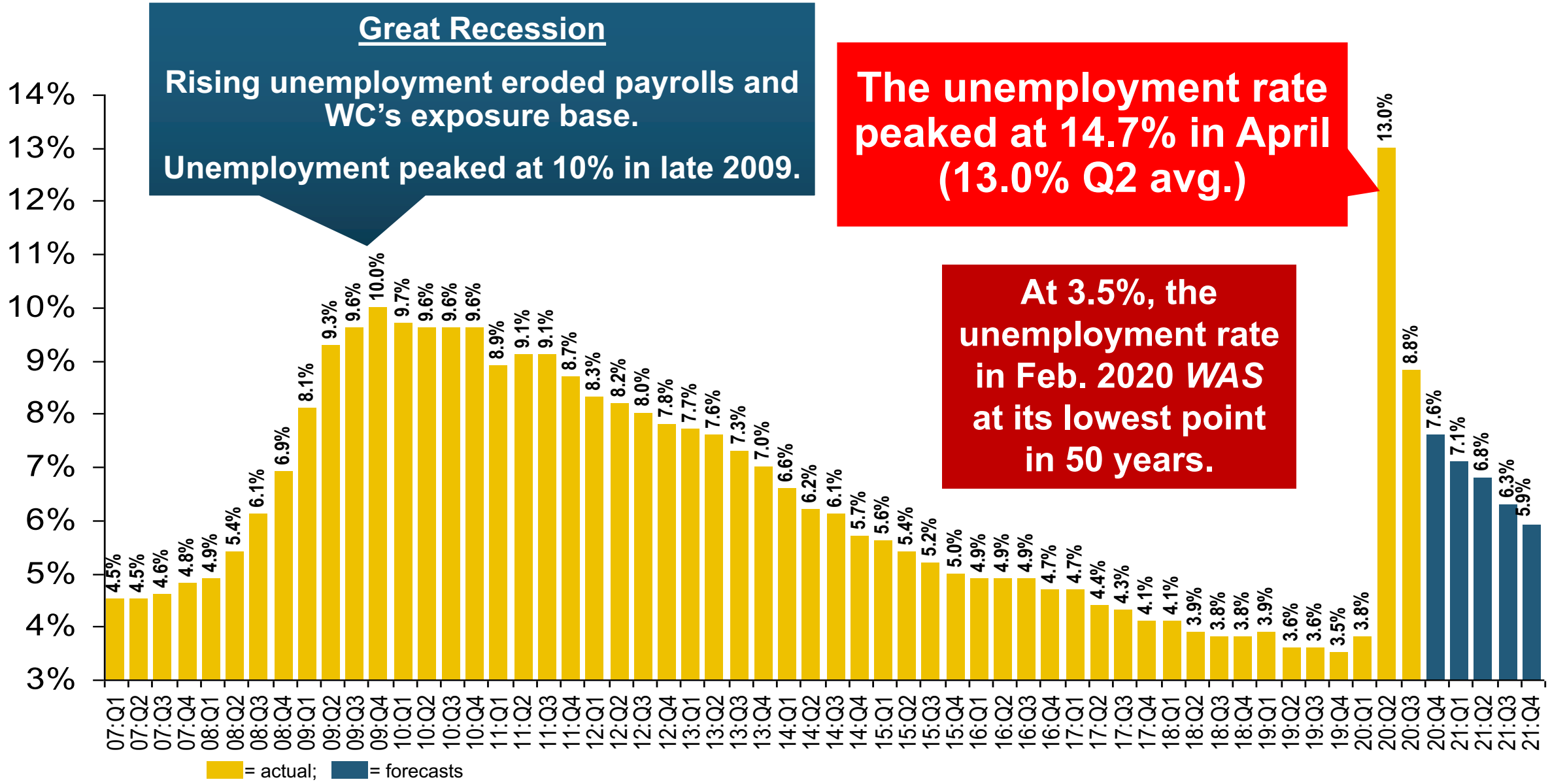
California:
Feb. 2020: 3.9% (record low)
Peak: 16.4% (Apr./May)
Aug. 2020: 11.4%

11.4M jobs were created from May through Sept. (after a loss of 22.2M in March/April) helping bring down the unemployment rate to 7.9% from its April peak of 14.7%. So far, ~50% of jobs lost have been recovered.



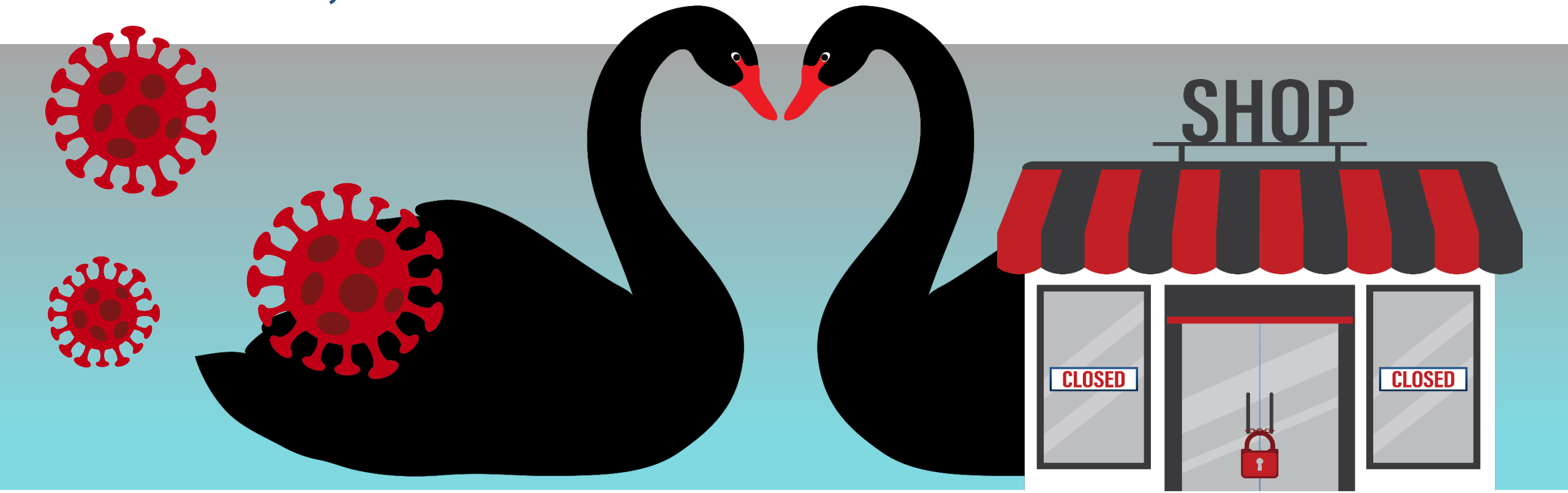
Source: US Bureau of Labor Statistics; Risk and Uncertainty Management Center, University of South Carolina.

US Unemployment Rate Forecast: 2007:Q1–2021:Q4



Sources: US Bureau of Labor Statistics; Wells Fargo Securities (10/20 edition); Risk and Uncertainty Management Center, University of South Carolina.

Government Mandated Business Closures Were the Real Black Swan, Not the Coronavirus



- The US (and world) has endured several other major infectious disease outbreaks killing 100,000+ Americans without shutting down the economy
  - Hong Kong Flu (1968-70)
  - Asian Flu (1957-58)

- It is the reaction to the virus that is unprecedented and represents the *true* Black Swan event
- The ramifications of this decision will be consequential for a generation (e.g., $3 trill. in debt)

Sources: CDC; Risk and Uncertainty Management Center, University of South Carolina

Commercial Lines Growth, Underwriting Performance & Pricing Cyclicality

Pricing Pressures Are Intensifying

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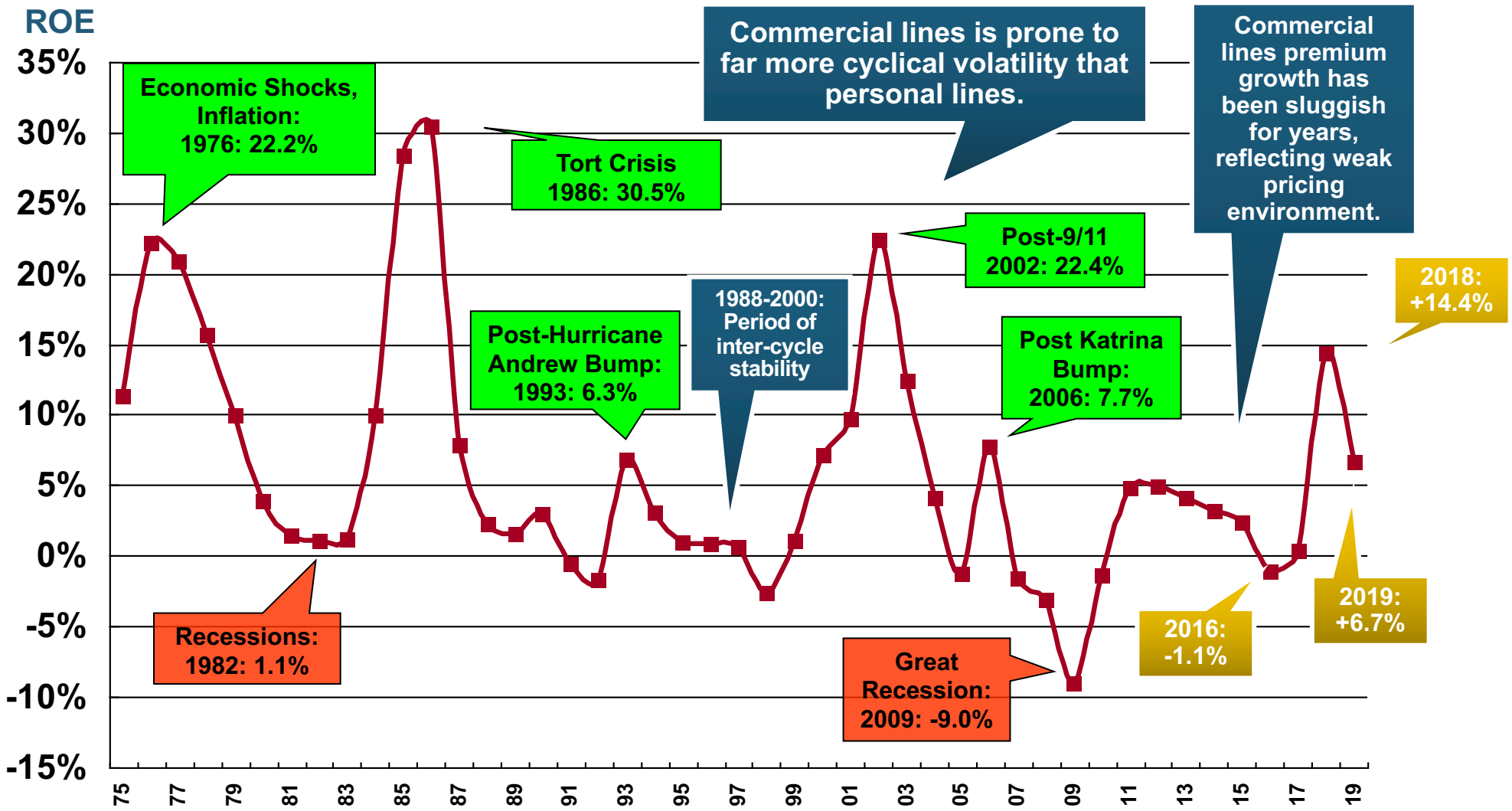
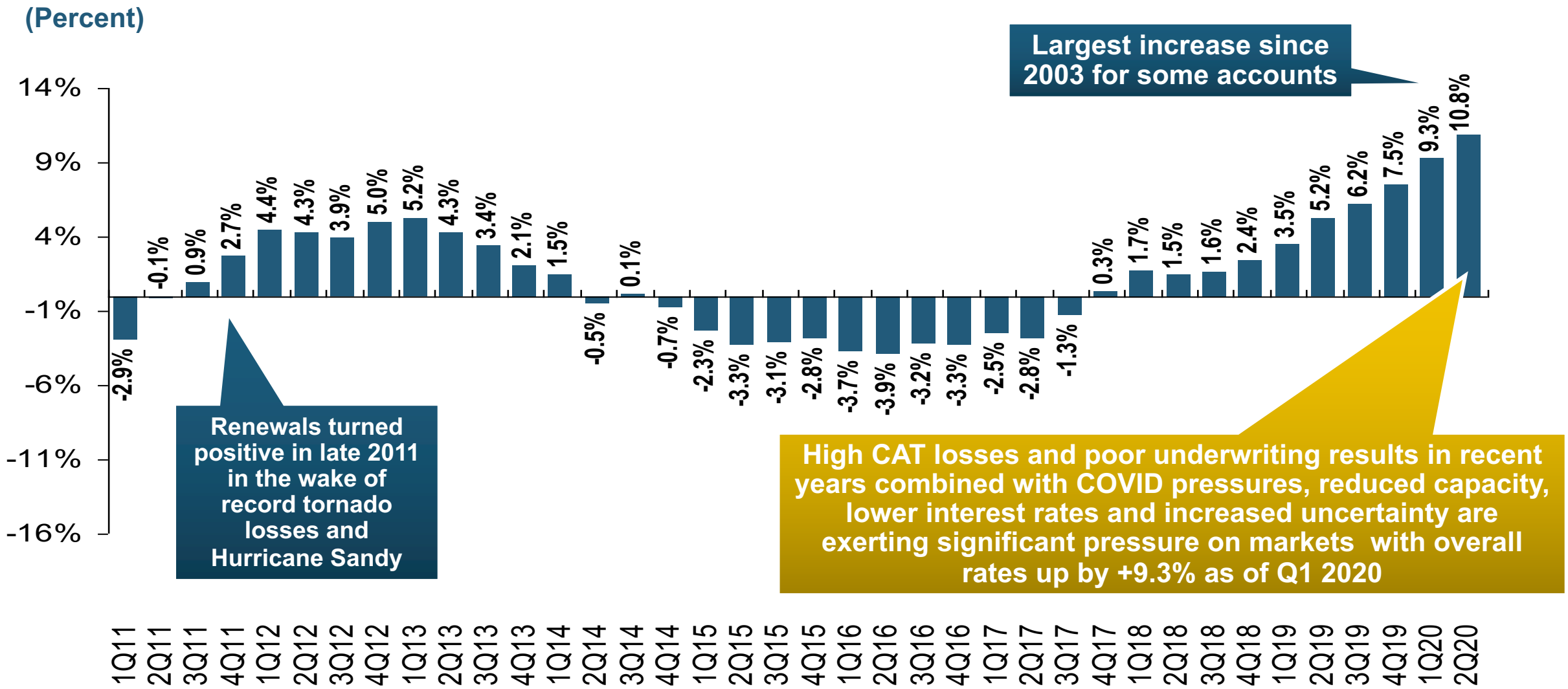
Commercial Lines NPW Premium Growth: 1975 – 2019



Note: Data include state funds beginning in 1998.
Source: A.M. Best; Insurance Information Institute; Univ. of South Carolina Center for Risk and Uncertainty Management, ISO.

CIAB: Average Commercial Rate Change, All Lines, 2011:Q1–2020:Q2*

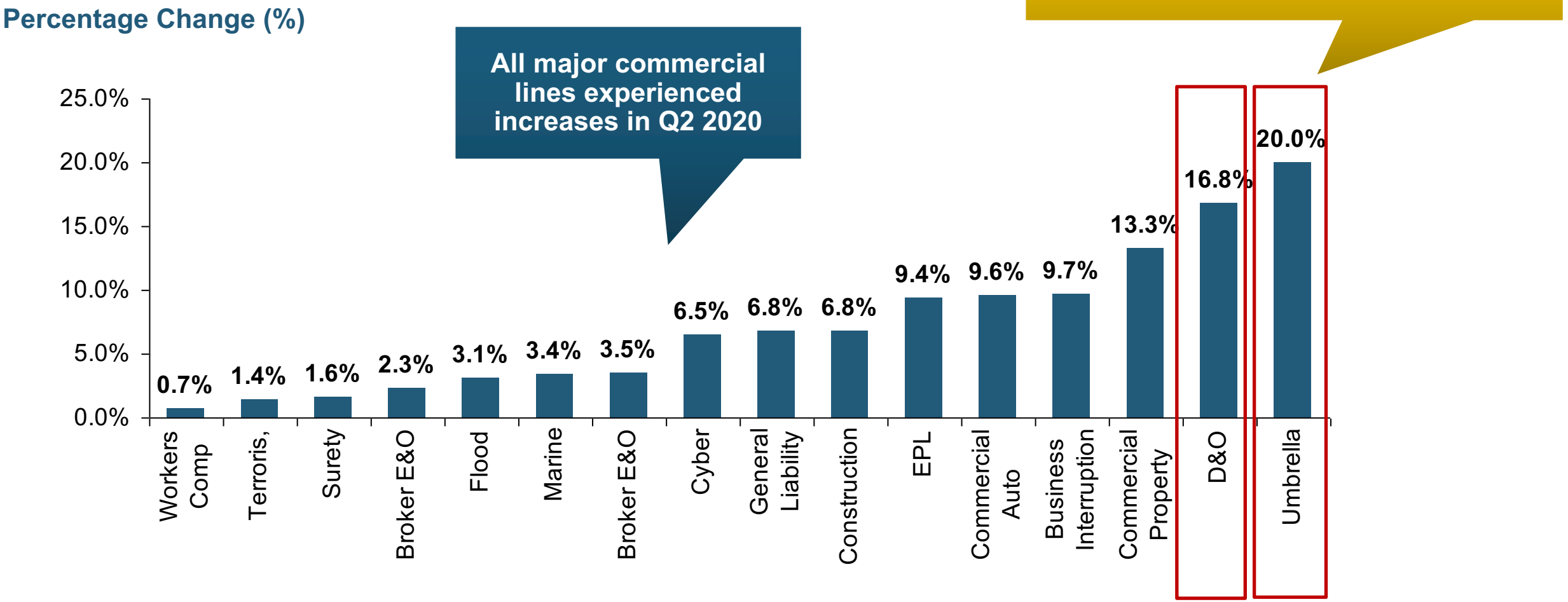


*Latest available.
Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially.
Source: Council of Insurance Agents & Brokers; Center for Risk and Uncertainty Management, Univ. of South Carolina.

Change in Commercial Rate Renewals, by Line: 2020:Q2

Umbrella now leads all major commercial lines in terms of rate gains, exceeding D&O and CP

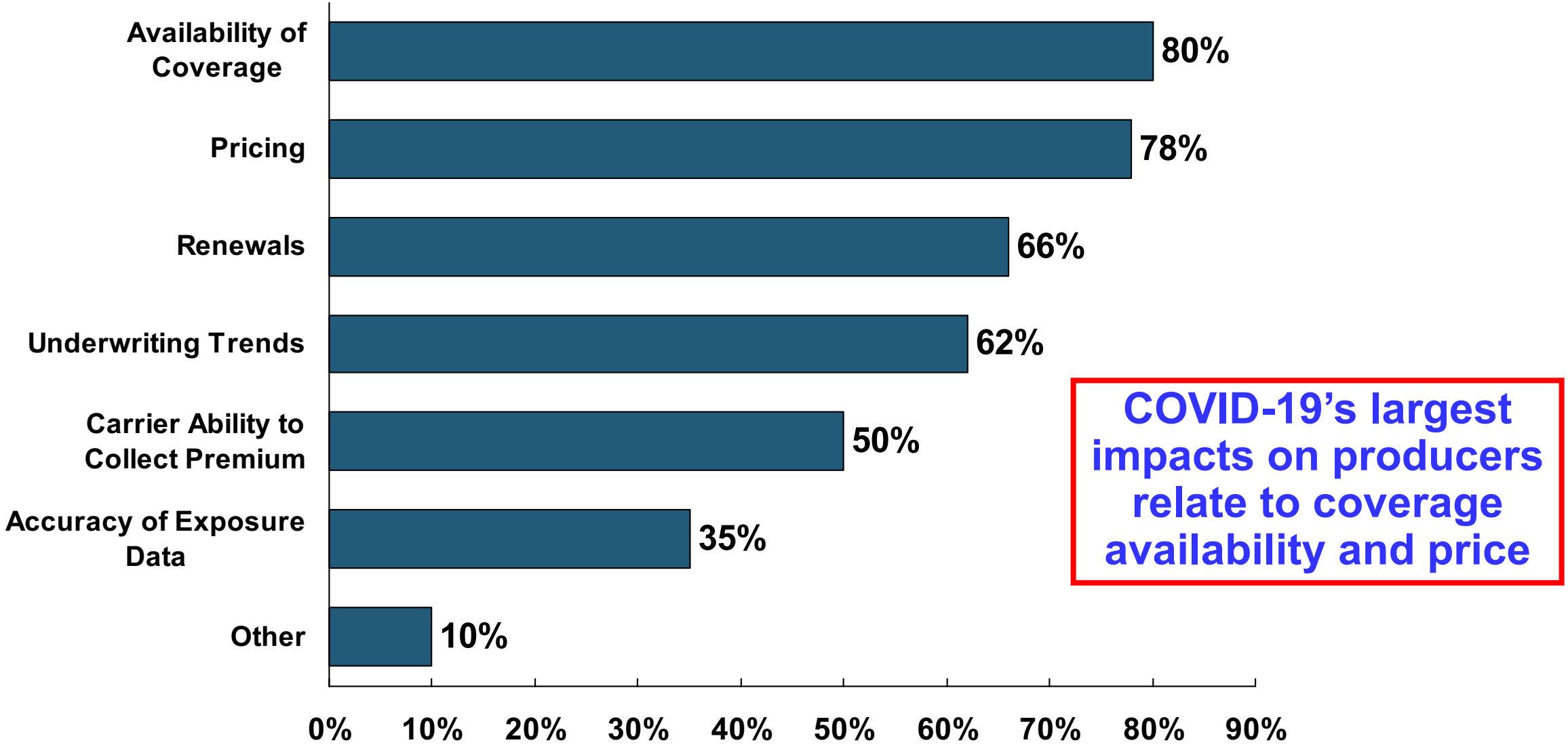
All major commercial lines experienced increases in Q2 2020



Note: CIAB data cited here are based on a survey. Rate changes earned by individual insurers can and do vary, potentially substantially.

Source: Council of Insurance Agents and Brokers; USC Center for Risk and Uncertainty Management.

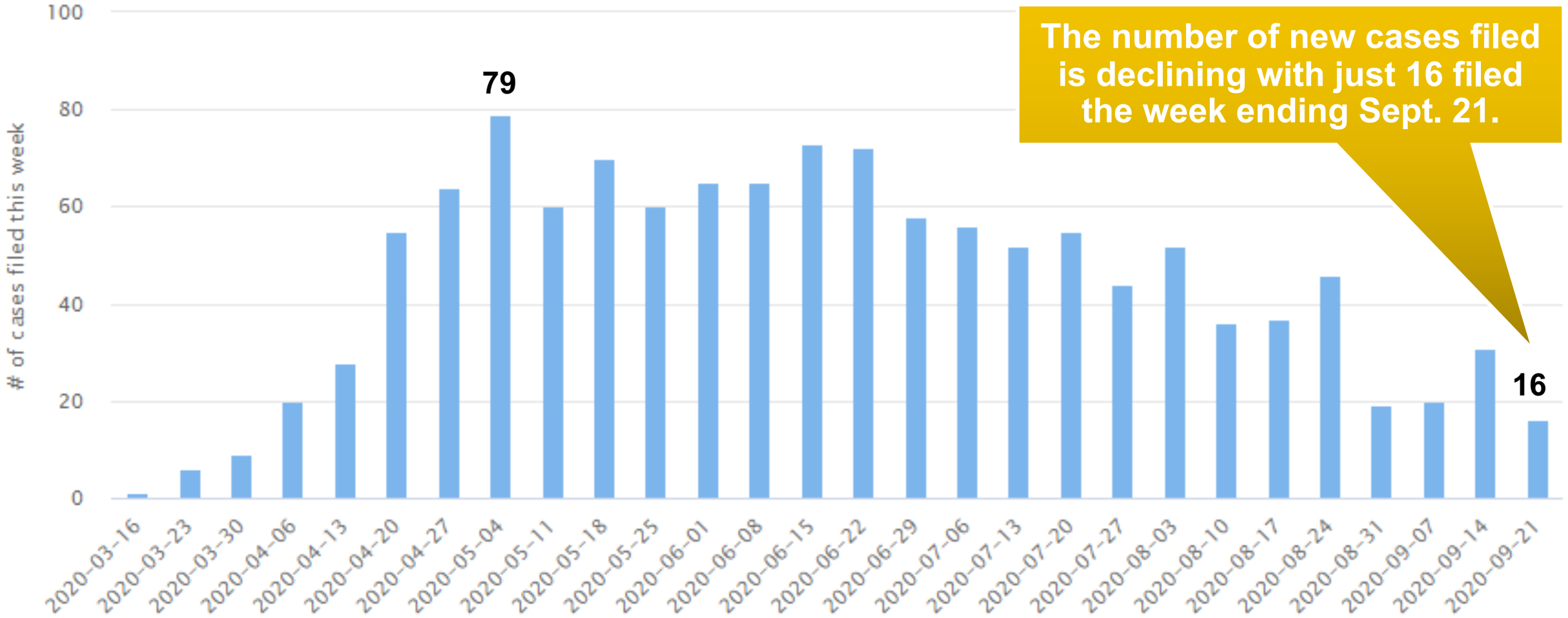
COVID-19 Issues Impacting Producers, 2020:Q2*



COVID-19's largest impacts on producers relate to coverage availability and price

Note: CIAB, Q2 2020 *COVID-19 Supplement* accessed at: https://www.ciab.com/download/25840/; Risk and Uncertainty Management Center, University of South Carolina.

Weekly Number of COVID-Related Lawsuits Filed:
(Weeks Ending Mar. 16, 2020 to Sept. 21, 2020)



Source: Covid Coverage Litigation Tracker, University of Pennsylvania School of Law. Accessed 10/10/20 at: https://cclt.law.upenn.edu

Tort Environment: The Return of Social Inflation?

Tort Costs Are Under Pressure from a Variety of Different Factors

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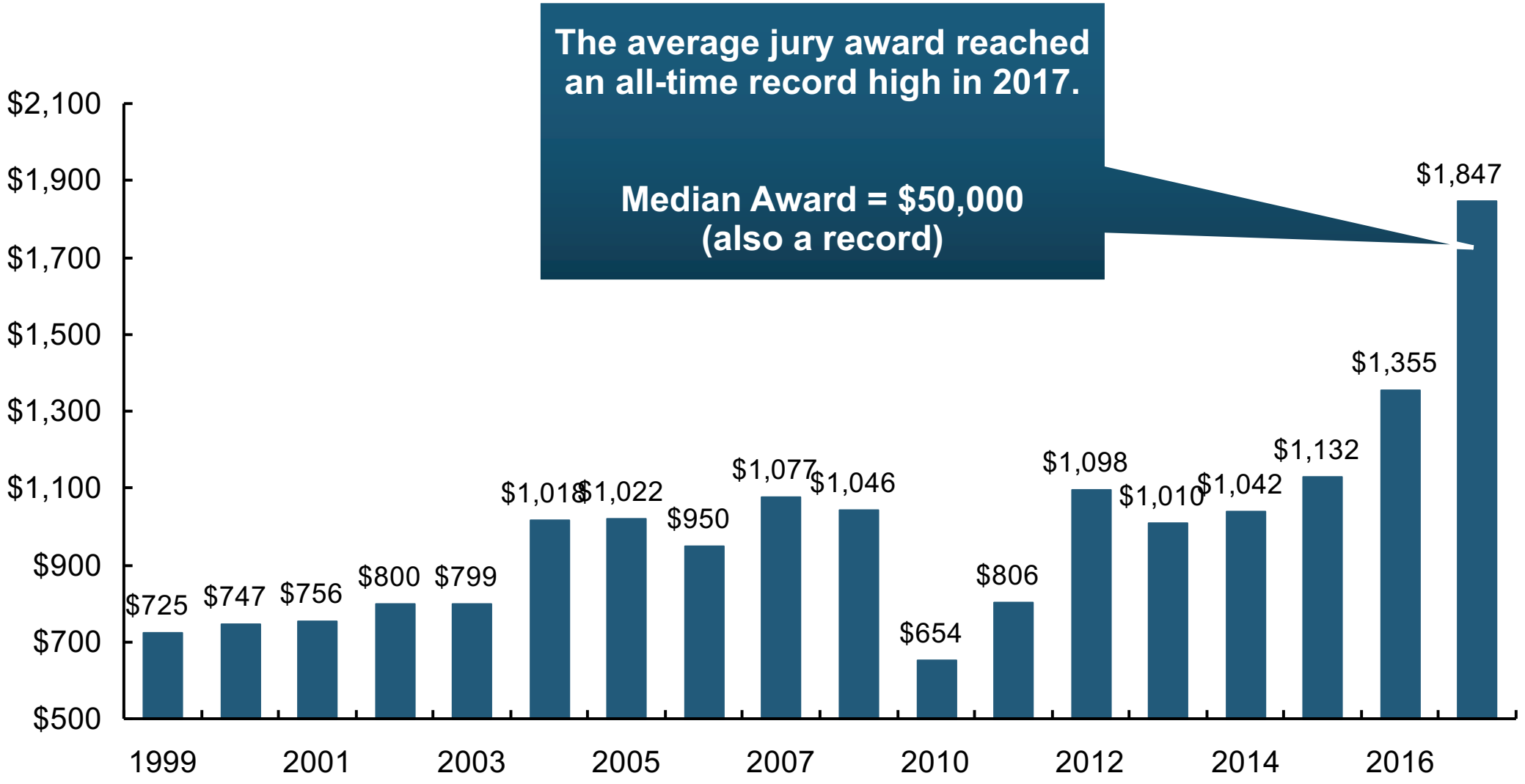
Average Jury Awards, 1999 – 2017 (latest available)



Source: Jury Verdict Research; *Current Award Trends in Personal Injury* (58th Edition), Thomson Reuters; Risk and Uncertainty Management Center, Univ. of South Carolina.

The Nation's Judicial Hellholes: 2019 – 2020

Watch List

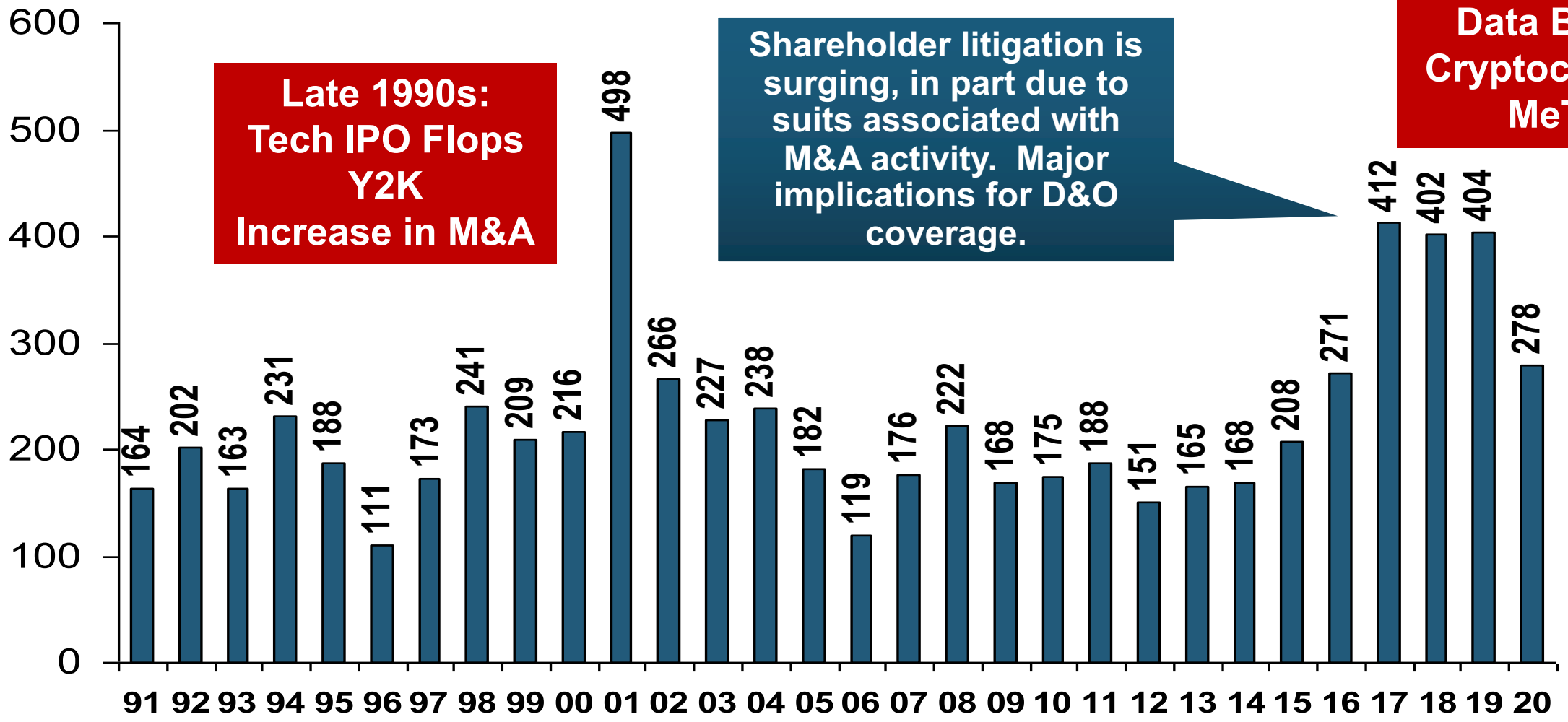
- CO Supreme Court
- Florida
- MD General Assem.
- MT Supreme Court
- PA Supreme Court
- WV Supreme Ct.

Dishonorable Mention

- AK Supreme Court
- KS Supreme Court
- OR Supreme Court

Source: American Tort Reform Association; Risk and Uncertainty Management Center, Univ. of South Carolina.

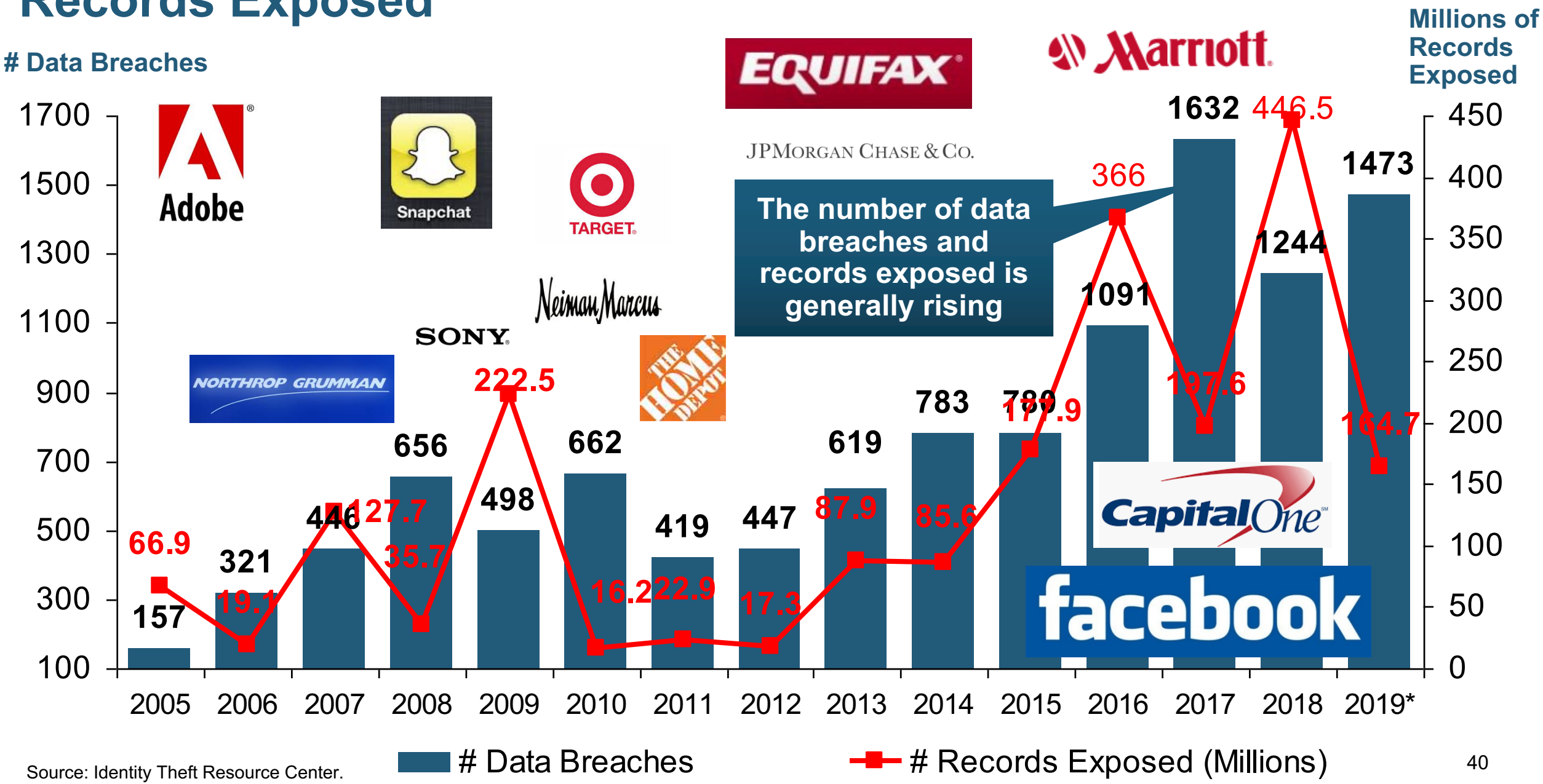
Shareholder Class Action Lawsuits*



*As of Oct. 9, 2020.

Source: Stanford University School of Law (securities.stanford.edu); Risk and Uncertainty Management Center, Univ. of South Carolina.

Data Breaches 2005-2019, by Number of Breaches and Records Exposed



Source: Identity Theft Resource Center.

Federal and State COVID-19 Initiatives Impacting Commercial Insurers

P/C Insurance Coverage & COVID-19

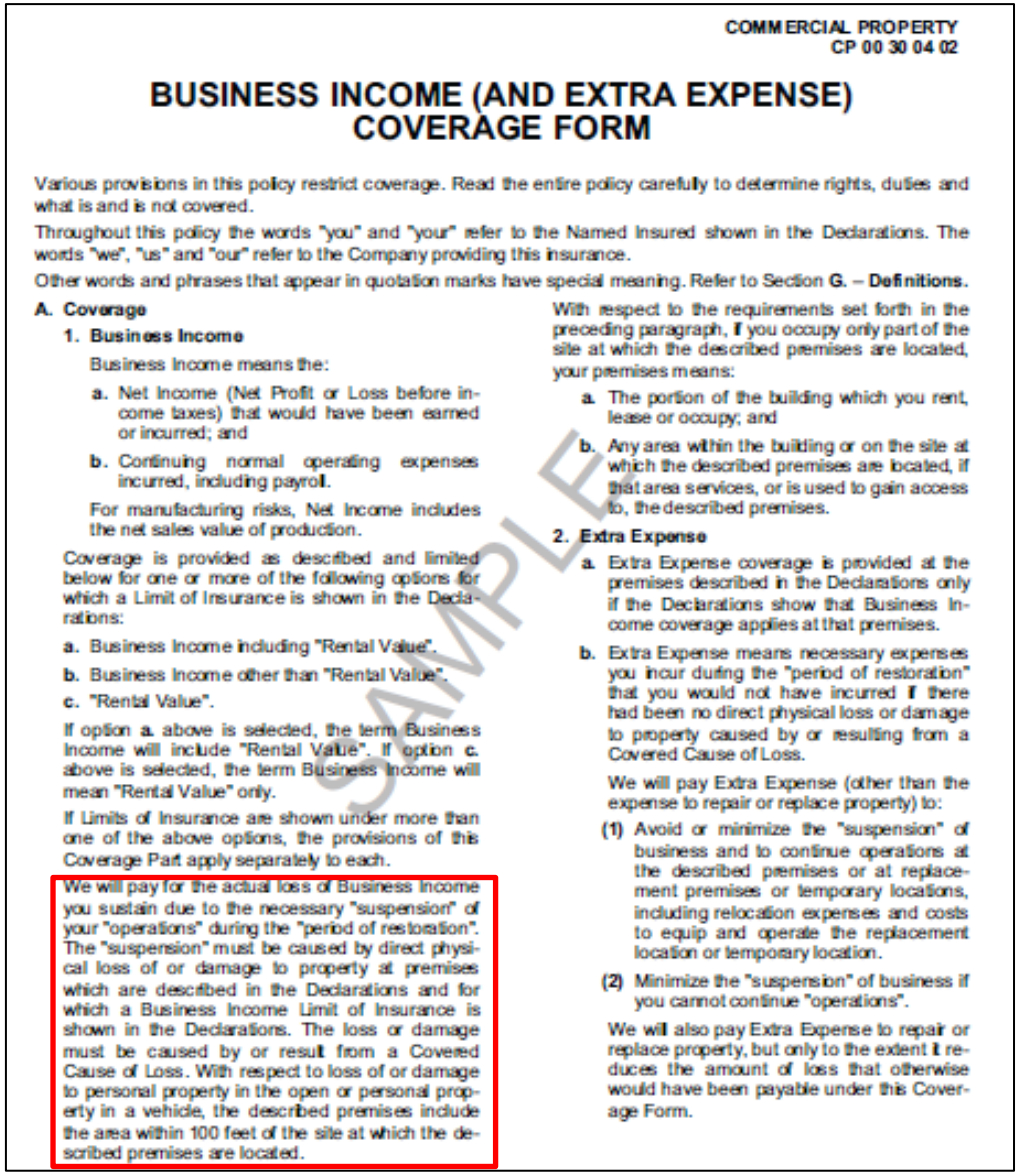
- **Insurers have received tens of thousands of claims related to COVID-19 losses**
  - **Workers comp**
  - **Business Interruption**
  - **GL**
  - **Event Cancellation**
  - **Travel Insurance**
  - **D&O**
  - **Trade Credit**
  - **Mortgage**
  - **EPL**
- **Crises tend to precipitate efforts to stretch contract language in an effort to:**
  - **Find coverage where none exists**
  - **Find coverage where none was intended**
  - **Find coverage for which no premium was paid**
- **Politicians frequently pile on: Zero political risk**

Business Interruption Coverage (BIC) & COVID-19

- **Business interruption policies clearly exclude COVID-19 claims**

- **The ISO Business Income form contains the following language:**

  - ***"We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to property…The loss or damage must be caused by or the result of a covered cause of loss." [from ISO form: CP 00 30 04 02]***



COMMERCIAL PROPERTY
CP 00 30 04 02

BUSINESS INCOME (AND EXTRA EXPENSE) COVERAGE FORM

Various provisions in this policy restrict coverage. Read the entire policy carefully to determine rights, duties and what is and is not covered.

Throughout this policy the words "you" and "your" refer to the Named Insured shown in the Declarations. The words "we", "us" and "our" refer to the Company providing this insurance.

Other words and phrases that appear in quotation marks have special meaning. Refer to Section **G. – Definitions.**

A. Coverage

1. Business Income

Business Income means the:

a. Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred; and

b. Continuing normal operating expenses incurred, including payroll.

For manufacturing risks, Net Income includes the net sales value of production.

Coverage is provided as described and limited below for one or more of the following options for which a Limit of Insurance is shown in the Declarations:

a. Business Income including "Rental Value".

b. Business Income other than "Rental Value".

c. "Rental Value".

If option **a.** above is selected, the term Business Income will include "Rental Value". If option **c.** above is selected, the term Business Income will mean "Rental Value" only.

If Limits of Insurance are shown under more than one of the above options, the provisions of this Coverage Part apply separately to each.

We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. With respect to loss of or damage to personal property in the open or personal property in a vehicle, the described premises include the area within 100 feet of the site at which the described premises are located.

With respect to the requirements set forth in the preceding paragraph, if you occupy only part of the site at which the described premises are located, your premises means:

a. The portion of the building which you rent, lease or occupy; and

b. Any area within the building or on the site at which the described premises are located, if that area services, or is used to gain access to, the described premises.

2. Extra Expense

a. Extra Expense coverage is provided at the premises described in the Declarations only if the Declarations show that Business Income coverage applies at that premises.

b. Extra Expense means necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss.

We will pay Extra Expense (other than the expense to repair or replace property) to:

(1) Avoid or minimize the "suspension" of business and to continue operations at the described premises or at replacement premises or temporary locations, including relocation expenses and costs to equip and operate the replacement location or temporary location.

(2) Minimize the "suspension" of business if you cannot continue "operations".

We will also pay Extra Expense to repair or replace property, but only to the extent it reduces the amount of loss that otherwise would have been payable under this Coverage Form.

SAMPLE

Update on Business Continuity Disputes

- **Large number of BI suits have been filed against insurers**
  - Most are still making their way through the court system…BUT
- **Since mid-2020 numerous courts have made decisions favoring insurers across a growing number of industries (not just restaurants)**
- **Courts have generally found that:**
  - Virus exclusions found in many policies are unambiguous and are binding
  - That BI coverage is necessarily triggered only when there is actual physical loss or damage to property
  - Government mandated closures alone are insufficient to trigger BI coverage

Business Continuity Protection Program (BCPP)

- **Purpose:** The BCPP is designed to bolster the country's economic resilience by providing timely and efficient financial protection and payroll support to the private sector in the event of a future declared public health emergency.
  - Has support of several industry group: APCIA, NAMIC, Big I
  - No balance sheet risk to the insurance industry

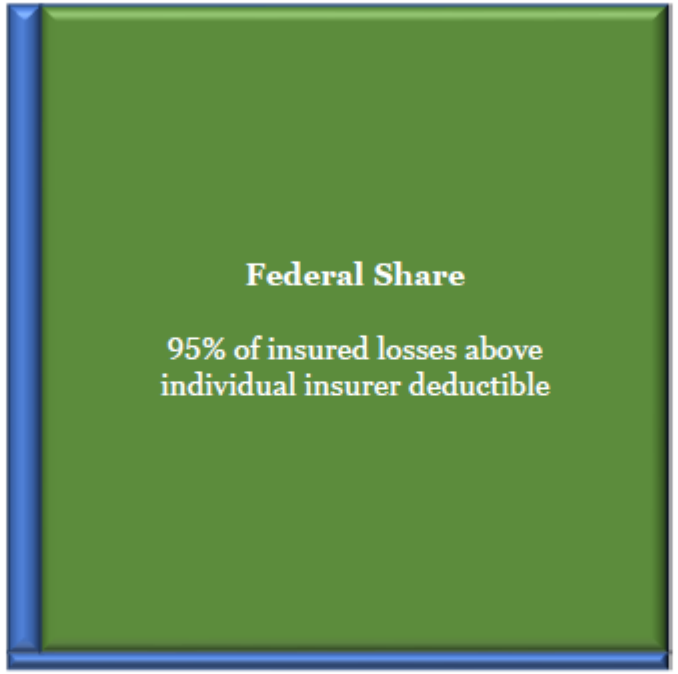
- **Structure:**
  - Businesses purchase revenue replacement assistance from the BCPP – up to 80% of payroll, employee benefits and operating expenses
  - Provides 3 months of relief payments
  - Payouts based on prior year's tax return
  - Relief is automatically triggered following a federally declared public health emergency

Source: APCIA

Why PRIA Is a Well-Intentioned but Bad Idea

Up to $37.5B in liability for insurers

Total potential insurer liability under PRIA is almost $50 billion—nearly double the insured property losses from 9/11 and larger than every disaster in history other than Hurricane Katrina



Insurer Co-Share
5% of insured losses above individual insurer deductible

The insurer deductible and liability cap are based on insured losses from all covered public health emergencies declared in any one calendar year.

Liability Cap
Neither insurers nor Treasury have any obligations above the liability cap.

Claim payouts are pro-rated if it appears the cap may be reached.

Potentially $12B of liability for insurers

Program Trigger
Treasury may not make a payment under the program unless total insured losses from a declared public health emergency exceed $250 million.

Individual Insurer Deductible
5% of insurer's prior year direct earned premium for most commercial property and casualty lines of business

The total of all individual insurer deductibles is about $12 billion.

Source: Risk and Uncertainty Management Center, University of South Carolina and Centers for Better Insurance, "*Pandemic Risk Insurance Act of 2020: Summary and Key Risks,*" June 2020.

SUMMARY

- **The P/C Insurance Industry Remains Strong, Stable, Sound and Secure**
- **The Rapid Economic Slowdown Will Temper P/C Growth, Especially in Economically Sensitive Lines (especially Workers Comp)**
- **Asset Price Volatility Will Persist and Low Interest Rates Will Pressure Investment Earnings for Years**
- **COVID-19 Exposures Are Substantial but Manageable with Headline Risk on BI and WC Issues**

UNIVERSITY OF
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Thank you for your time and your attention!

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