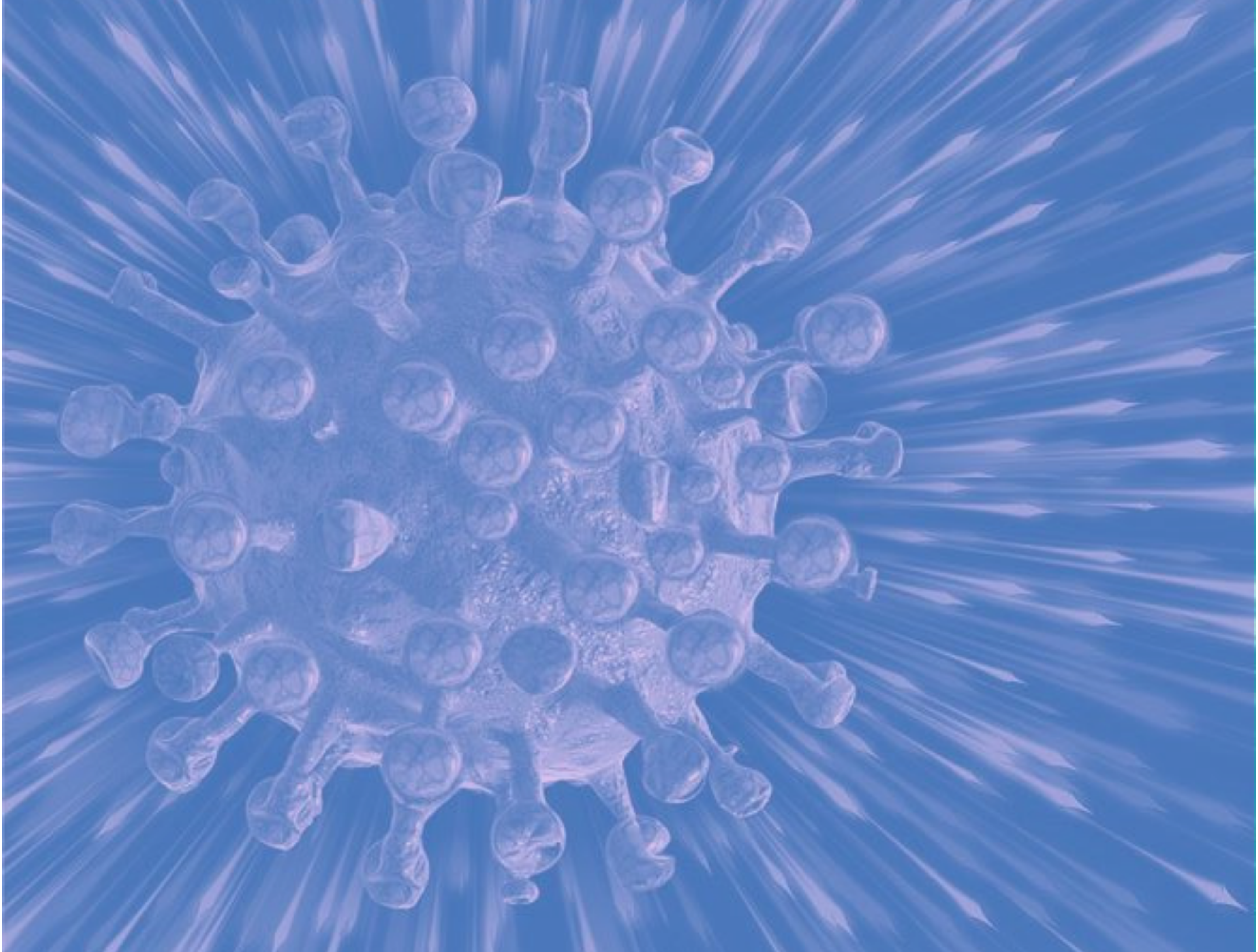
COVID-19 Newsletter

Edition 4 *17th April 2020*



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General Outlook

Many of you will have seen Bill Gates' insightful 2015 Ted Talk wherein he comes eerily close to predicting the viral outbreak, "if anything kills over 10 million people in the next few decades, it's most likely to be a highly infectious virus rather than a war — not missiles but microbes". He goes on to say, "we have invested a huge amount in nuclear deterrents, but we've actually invested very little in a system to stop an epidemic. We're not ready for the next epidemic." He was quite right.

Earlier this year, the co-founder of Microsoft suggested that a state of readiness, "would have meant that we would have had diagnostics very quickly, drugs very quickly, even a vaccine — all of those things — dramatically faster than what we're going through here." We cannot expect to be ahead of every scenario, here lies the value proposition of insurance. Nonetheless, there is an overriding sense that we are playing catch up. The insurance industry has also been considered by some to have been unprepared – at the least, in an unclear communication of function and purpose.

"Dear Colleague" letters arriving on the desk of President Trump continue to amass as the battle over the obligations of the insurance market continues to rage. With early communications pushing insurers to pay, a number of senators and congressmen have now put pen to paper to formalise their concerns with forced pay-outs. These contentions have spread to further jurisdictions, most prominently the United Kingdom, with insurance reaching the national headlines. In the current climate, who gets what and from where is a tough and impassioned consideration.

This week, we look towards how society might be better protected from the economic shock of a pandemic. Director General of the Association of British Insurers Huw Evans stressed that governments and insurers must come together to decide the extent to which coverage should be mandated and how best to offer it[1]. It is evident that a return to the status quo would be unacceptable.

The popular option for progress is a state-backed protection gap entity. Examples exist around the world. In the UK, Flood Re and Pool Re, protecting flood and terror risk. In the US, the Terrorism Risk Insurance Programme (TRIA). CCR in France, providing reinsurance for natural disasters, terror and credit risk. The California Earthquake Authority and the Earthquake Commission in New Zealand.

The earliest proposal comes from the US in the form of the Pandemic Risk Insurance Act which puts forward a draft for a pandemic-focused facility, based on TRIA. Concerns have already been raised surrounding its structuring, take-up and the ability to offering reasonably priced cover. We discuss these later in this newsletter, along with potential alternatives to the state backed facilities.

It is indisputable that the increasingly interconnected nature of the world has enabled the spread of this viral pandemic and may increase the opportunity for a resurgence. However, that very characteristic has helped healthcare systems to tackle the virus more effectively, for epidemiologists to better track its spread and hopefully it will expedite the production of a vaccine for its ultimate defeat. It is important that the insurance market take advantage of this collaborative approach to develop the optimum system to better prepare for what may lay ahead.

[1] Source: https://www.abi.org.uk/news/news-articles/abi-we-need-to-talk-about-pandemic-insurance/

Hitting the Headlines – Hiscox PLC

A 'Hiscox Action Group' has been set up by a number of UK businesses who believe that the FTSE250 insurance firm is "determined to avoid its obligations". The dispute focuses on the policy wording of Hiscox's UK commercial combined policies, notably two sections concerning coverage for BI losses without physical damage.

1. The first section is titled "Non-damage denial of access", where clients can claim if there is "an incident occurring during the period of insurance within a one mile radius of the insured premises which results in a denial of access or hindrance in access to the insured premises, imposed by any civil or statutory authority or by order of the government or any public authority, for more than 24 consecutive hours".
2. Another section entitled "Public authority" allows clients to claim if they cannot use their insured premises "due to restrictions imposed by a public authority during the period of insurance". Triggers to this include "an occurrence of any human infectious or human contagious disease, an outbreak of which must be notified to the local authority".

Hiscox believes that of UK businesses who purchase cover for BI, only 10,000 have been directly impacted by the government mandated closures, and that its realistic disaster scenario estimates a loss of $175m due to the pandemic. This figure may increase drastically given that it offers limits of up to £100,000 to 1.2m small business customers, a large proportion of which have operations in the UK.

FCA Comment

In an open letter to CEOs, the FCA stated that in most cases, policies "do not cover pandemics and therefore would have no obligation to pay out in relation to the COVID-19 pandemic. While this may be disappointing for the policyholder we see no reasonable grounds to intervene in these circumstances." This comes after the Association of British Insurers fought hard to not have retroactive cover put in place due to fears it would bankrupt insurers if they were forced to pay invalid COVID-19 claims.

They do however go on to stress that where it is clear that the firm has an obligation to pay out on a policy, it is important that these claims are settled quickly. In cases where disputes arise, the letter notes that small business who fit the criteria should go to the Financial Ombudsman Service to achieve faster decisions than a Court process and more timely payments.

The FCA has also set up a small business unit to coordinate the activities of the FCA across small business issues, ensuring regulated firms are supported through the challenges, learning about the treatment of small businesses by financial services firms and ensuring a coordinated response by the FCA to any issues identified.

Pandemic Risk Insurance Act 2020 – PRIA

In the wake of the 9/11 terrorist attacks, the Terrorism Risk Insurance Act was introduced to US Federal Law to enable commercial insurers to provide reasonable terror coverage to those policyholders that need it. Despite the fact that the Act was initially due to expire at the end of 2005, it still exists today in the form of the Terrorism Risk Insurance Program Reauthorization Act, and has been extended until the end of 2027. This illustrates the success of the scheme in providing comfort to insurers and policyholders alike.

A similar act is in the early phases of development in the United States in response to the COVID-19 outbreak – the Pandemic Risk Insurance Act (PRIA) of 2020. A first 'Discussion Draft' of the bill has been drawn up, with many hopeful that it will be introduced to the House of Representatives as early as the end of April.

The purpose of the act is to establish a Federal Program that provides for "a transparent system of shared public and private compensation for business interruption losses resulting from a pandemic or outbreak of a communicative disease."[2] Insurers would be charged a premium for the reinsurance coverage which would be deposited into a Pandemic Risk Reinsurance Fund maintained by the Treasury to pay insured losses and to cover the costs associated with administering the program.

Key aspects of the program are summarised below, but it is key to note that these are subject to change:

- Insurer participation would be **voluntary** – this is unlike TRIA whereby insurers providing certain lines of business cover must make terrorism cover available.
- Program trigger is set at **$250m** aggregate industry insured losses resulting from a covered public health emergency
- Aggregate annual liability set at **$500bn**
- Insurer retains **5%** of insured losses in excess of the program trigger
- **95%** federal share of compensation for insured losses in excess of the program trigger up to the aggregate annual cap

Concerns and Criticism

In an open letter addressed to Donald Trump on Good Friday, multiple Senators stated that it is critical priorities are kept in order amongst all the chaos, stressing the importance of dealing with the problems caused by COVID-19 before looking to address any future pandemics. They went on to voice their concerns on the proposed PRIA scheme, stating that they "remain very sceptical that any such proposal would be able to provide the appropriate coverage at an appropriate price for our nation's small businesses"[3].

This lack of enthusiasm towards the scheme has been echoed elsewhere in the market. Modelling the structure of PRIA based on that of TRIA is fundamentally flawed – carriers can model the severity of a

[2] Source: https://d1198w4twoqz7i.cloudfront.net/wp-content/uploads/2020/04/09183618/Pandemic-Risk-Reinsurance-Act-Discussion-Draft.pdf
[3] Source: https://www.ciab.com/download/23119/

terrorist attack but fall down when it comes to modelling the frequency. The reverse is true when modelling pandemics – the frequency can be modelled but the severity cannot. They are deemed inherently different risks thus the resolution for pandemics should not mirror that of terrorism.

Another potential flaw is that the draft bill in its current form makes no mention to retrocession or risk transfer for the program. The bill could, for example, state that the program could be used to leverage other reinsurance alternatives to transfer or hedge some of the risk to sources of capacity other than the government. This would increase the sustainability of the program by reducing the burden on the Government and therefore the taxpayer.

Another Option?

Another idea that is only in its conceptual phase is one that would resemble the National Flood Insurance Program (NFIP). Here, carriers could opt in to working administratively with the federal government. Commercial policyholders' premium payments would be collected as a surcharge by carriers and passed on to the government to build up a pool of money to aid in future pandemics. Only once this pre-established pool has diminished would the government be required to step in.

A few considerations:

- The NFIP frequently runs at a deficit. As such, it is a mechanism for providing cover to insureds at affordable pricing, but one that often costs the state when it requires capital injection.
- Flooding has a much higher frequency of loss than pandemic risk – this may allow a greater fund to develop initially.
- Might the take up of flood cover be higher than pandemic cover if this was to be a voluntary facility for underlying insureds?

International Responses

World Bank Pandemic Bonds

- Remarkably, the World Bank's pandemic bonds which launched in 2017 to assist developing nations in the event of a pandemic, are still yet to be triggered as the final criterion had not been satisfied.
- This will create a valuable lesson to global policymakers in the future regarding the structure of future Pandemic Cat Bonds and their requirement to react more dynamically to stop pandemic outbreaks in developing countries.

United Kingdom

- Lloyd's of London is set to announce a GBP 30M donation towards a COVID-19 response.
- Half of this will go to charitable causes which will address the challenges COVID-19 has caused, while the other half looks likely to be a contribution towards a potential UK backstop facility.

African Risk Capacity (ARC)

- A regionalised African risk pool which was originally created as a parametric sovereign disaster fund to help nations provide drought insurance is intending to add coverages for pandemics in its 2021 launch.
- The pool looks set to utilise a layered approach to financing:
    - Layer 1 – country participation retention- member countries retain risk
    - Layer 2 – risk pool reserves- each participant contribution
    - Layer 3 – risk transfer- reinsurance and alternative capital
- The product will seek to provide countries with early intervention financing, enabling them to understand the risk that they face, cost these risks and then insurance is provided to underwrite to ensure capital efficiency.

China

- In February, the Hainan province in Southern China launched the first specifically designed policy to help businesses recover from the COVID-19 outbreak.
- 12 private insurance companies, including Chinese giants PICC and China Pacific launched a scheme covering business losses for 6 months.
- The Hainan government subsidised 70% of premiums for key businesses to enable them to purchase this insurance.

Parametric Insurance – The Business Interruption Bridge?

Having now realised the short fallings of their business interruption policies, many risk managers are scrambling to find ways of bridging the gap in coverage. One potential alternative comes in the form of parametric insurance products or index-based policies, products that do not indemnify pure loss, rather pay a pre-defined amount to the purchaser upon the occurrence of a measurable event. The first such products were trialled in the 1990s in Asia to assist farmers with their weather-based exposures. Since the early days, advances in technology and data quality have allowed for a much more developed product offering. Tech giant Alibaba sold 1.1 billion parametric policies relating to flight delays in one day in November of 2018[4]. The question is, can this be applied to more complex, less well modelled exposures.

Demand and enquiry around parametric insurance has increased significantly in the first quarter of 2020. Since its launch in mid-2018, Marsh's parametric insurance product PathogenRX, developed alongside Munich Re and Metabiotica, had seen very little demand – they now value potential premium levels at as much as $1.5 billion a year[5]. The policy provides business interruption cover in the event of a pandemic, using a pathogen sentiment index developed by the US-based tech company that evaluates behavioural change and concern following an outbreak.

A pandemic-focused parametric product does not necessarily need to have the trigger of, say number of infections. It is possible for the product to respond to a wider measure, or one that is industry specific. For example, if a particular metric falls below a set threshold such as; global air traffic, footfall through city centres, restaurant bookings or hotel occupancy. It is important that the index used is well correlated to the covered exposure, this minimises the key issue with parametric cover – basis risk.

Parametric covers help to offer something that the insurance industry is currently struggling with – trust. Extensive claim disputes are almost entirely avoided, once an index is triggered, the policy pays out. This is however predicated on the index being based on publicly available, incorruptible data.

Integrating blockchain technology within the product would allow smart policies to pay out with minimal human interaction, reducing cost – another industry demon. As potential opportunities to enhance the efficiency of insurance delivery, index-based covers have been the focus of many Insurtech companies, as they lend themselves to model-based, data-driven, low engagement businesses. Though the enticement of a rapid pay-out might drive demand, there are significant issues with the covers.

[4] Source: https://www.linkedin.com/pulse/why-parametric-future-insurance-george-kesselman/
[5] Source: http://www.rmmagazine.com/2019/04/01/the-evolution-of-parametric-insurance/

Drawbacks of parametric covers

Basis risk – the insured may incur a loss while the overall trigger may not be satisfied and receive no pay-out. There is an all or nothing nature to the product.

Limit of cover – the cover offers limit for the approximate loss, rather than the actual loss of the insured.

Demand profile – often demand surges for these products immediately after a loss, as we see currently with the Coronavirus outbreak. This is arguably when the risk profile is most benign.

Metric source reliability – as the triggers become more complex, the trustworthiness of data becomes an ever more implicit concern. This may become a target for cyber criminals falsifying data output.

Cost – especially within the casualty space, it will be difficult to compete with bespoke indemnity coverages.

As data continues to be emancipated and effectively harnessed, these products will become more intelligent and tailored to the needs of prospective insureds. Some of the issues outlined above will be overcome, such as managing basis risk with staggered pay-out structures, allowing for partial pay-outs depending on sub-triggers. A greater diversity of emerging and existing risk could also be covered, such as reputational loss or a loss of following from a particular social media "storm"[6].

Many consider parametric covers to stray too far away from the core intention of insurance products. That they will only advance as independent financial products, removed from the insurance world. From this perspective, they may remain as a discretionary or luxury purchase in addition to insurance coverages.

As we discussed earlier, we expect a combination of the private and ILS insurance markets alongside the state, to offer viable solutions to protect against pandemic exposure. Until such a time that this is made available to citizens and businesses, we may well see a rise in the demand for parametric insurance products. It may also be worth considering that the confidence of business owners in their insurance products will have taken a significant hit through the turmoil of the COVID-19 outbreak, perhaps pushing them towards new ways of managing risk.

[6] Source: http://www.rmmagazine.com/2019/04/01/the-evolution-of-parametric-insurance/

Parsyl ColdCover Parametric – Cutting Edge Example

Parsyl, a Lloyd's approved Coverholder, has successfully raised $15m in funding, led by GLP and Ascot Group, enabling them to announce their new 'ColdCover' parametric insurance product. This high-tech data intensive product is the first of its kind in the Cargo market.

The parametric product developed by Parsyl covers single peril transit cover for temperature caused losses, covering seafood and life science products. The policy is triggered when the temperature breaches a level pre-determined according to the policyholders' needs.

The ColdCover parametric policy allows the policyholder access to Parsyl's quality monitoring and risk management platform, which provide invaluable insights allowing shippers to improve supply chain performance, reduce risk and lower insurance costs. Through this platform, Parsyl constantly monitors policyholders' products enabling it to quickly inform customers of any temperature breaches. If breaches do occur, payment is automatically made within 72 hours.

If you have any questions on parametric or index-based products, the Beach parametric team would be happy to discuss further at any time. Please do contact any member of the newsletter team and we will be able to facilitate a discussion.

[7] Source: https://www.parsyl.com/insurance

Insurance Stepping In

The insurance sector has received significant criticism and negative media attention as of late relating to its approach to handling COVID-19 claims. With a focus on business interruption, there has been widespread demand for claims to be paid despite contract wordings, lack of physical damage, and in some cases even with explicit exclusions. As has been previously stated by senior members of the private sector, many of these contracts were priced without relation to pandemic cause, so forcing insurers to shoulder the burden would both wipe out any surplus, with the potential for irreparable damage. Despite this, many are still stepping in with donations and support to help lessen the impact on SMEs, healthcare, and the wider economy.

Over in California, The State Compensation Insurance Fund announced that it will be establishing two new funds to help support essential workers during the pandemic. They are, the 'Essential Worker Support Fund' and the 'Essential Business Support Fund', both equating to $25 Million each. The first is designed to support state fund policyholders who are essential workers who either contract Covid-19 or are ordered to self-isolate due to a potential exposure. It will provide wage replacement for up to 6 weeks and assist any worker without health coverage with uncovered medical costs[8]. For workers with health coverage, it will assist with co-payments and deductibles as well as 6 weeks wage replacement. The second is designed to allow Business owners to apply for grants of up to $10,000 or two times the policyholder's premium (whichever is the lower), to help with expenses related to protecting their employees from Coivd-19[9]. The funds will pay both past and future expenses.

The introduction of these funds will undoubtedly help many businesses survive through this time of hardship, many other examples can be seen across the market:

- Swiss Re have pledged to donate CHF 5 Million (Approx $5.2 Million), to support communities affected by Covid-19. Through their non-profit organisation, the 'Swiss Re Foundation', funds will be distributed to help tackle the crisis, with a focus in developing countries[10].
- Chubb have launched a support program designed to ease the financial burden on its small business clients in the U.S and provide direct support to healthcare workers and other front-line responders. This comes after Chubb pledged $10 Million this month to Coronavirus pandemic relief efforts globally[11].
- Axis Capital have announced $1 Million in targeted philanthropic donations to support COVID-19 relief. The relief will be split into two separate funds; half going to organizations globally focused on supporting COVID-19 relief. The other half being allocated to addressing local needs in communities where Axis operates[12].

[8] Source: https://www.sacbee.com/news/coronavirus/article241989241.html
[9] Source: https://www.businesswire.com/news/home/20200413005365/en/State-Fund-Announces-50-Million-Special-Funds
[10] Source: https://www.swissre.com/media/news-releases/nr-20200414-swiss-re-donates-chf-5-million-to-covid-19-relief-efforts.html
[11] Source: https://www.chubbfiresecurity.com/en/uk/search.html?q=10+million+pledge
[12] Source: https://investor.axiscapital.com/file/Index?KeyFile=403604401

- Lloyd's of London – as noted earlier in this newsletter, Lloyd's have announced £30m of ringfenced funds, of which half will be going to UK and US charities focusing on dealing with the fallout from the COVID-19 outbreak.

Help you, Help me

Opportunities may be born out of offering help. Unico American Corp have begun distributing a suspended operations product. It offers cover for bars and restaurants at around 75% of the cost of the traditional product. Perils typically not experienced when operations are suspended are excluded.

A potentially attractive product in the current climate. The company then offers midterm endorsements to more traditional coverage at a time that suits insureds. An intelligent approach to developing demand when it may be dwindling.

Indirectly, with these funds and with others coming in, a different side of the industry might be portrayed which could lessen the criticism and demand for the insurance sector to wholly take the financial burden – exemplifying the social value that the industry offers. As well as further improving the reputation of these companies, Swiss Re saw an increase in share price after their CEO released a statement considering the pandemic as being "absolutely manageable"[14], news of donations and aid in these uncertain times will lead to a better outlook for all.

If you have any questions on anything discussed in this newsletter or any prior newsletter, the Beach parametric team would be happy to discuss further at any time. Please do contact any member of the newsletter team and we will be able to facilitate a discussion.

[13] Source: https://platform.mi.spglobal.com/web/client?auth=inherit#news/article?id=58049995&keyproductlinktype=4
[14] Source: https://www.swissre.com/risk-knowledge/building-societal-resilience/message-chairman-group-ceo-covid19-pandemic.html

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