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COVID-19 impact to property and casualty insurance

Actuarial perspective on 2020 loss reserves and future pricing

COVID-19 is impacting property and casualty (P&C) insurance companies and is expected to continue to affect claims and premium trends over the next several months, and potentially for years to come. As the debate continues on how to manage coverage exclusions related to viruses like COVID-19, the pandemic will likely disrupt investments, finance and capital, underwriting, claims, and actuarial functions due to catalytic events ranging from the closure of nonessential businesses to changes in state and federal regulations.

In this report, we review several lines of business and the potential disruption to claims and premium trends due to COVID-19. The situation is fluid and this article is based on information known as of the publication date. As the world continues to combat COVID-19, the impacts to P&C insurance policies will likely continue to evolve.

Workers' compensation

Mixed impacts

Workers' compensation insurers are expected to experience a wide array of impacts from the COVID-19 pandemic ranging from an anticipated loss of premium income, varying effects on claim frequency and severity, and a potential surge of customer touchpoints along with internal workforce disruption. This may increase the complexity in serving policyholders and injured workers. 2020 will not be business as usual.

Reduction in premium income

Reduction in premium income is expected as many policyholders reduce their workforce to manage current business needs, as observed during prior economic downturns. Specifically, workers' comp industry net written premiums decreased over 23 percent from $44.3 billion in 2007 to $33.8 billion in 2010 as carriers competed in a soft market while the pool of exposures diminished.[1] At the height of the prior economic downturn, the unemployment rate more than doubled from 4.8 percent at the end of 2007 to 10.0 percent by the end of 2009.[2] Although the length of the COVID-19 impact on workers' comp exposures is unknown, the speed of impact is immediate. Initial weekly national jobless claims of over 6.6 million each for the weeks of April 2 and April 9, 2020,[3] are both approximately 10 times the maximum number of weekly national jobless claims during the prior economic downturn in April 2009 of 665,000.[4]

Workers' comp premiums are initially determined using an estimate of the policyholder's payroll with a subsequent true-up calculation upon policy expiration. Typically, workers' comp carriers collect additional premiums as initial payroll estimates tend to understate exposures in the aggregate. However, during times of economic downturn the opposite occurs and carriers tend to return premiums upon policy expiration.

At the time of prior economic downturns, audit premium returns were a normal occurrence. COVID-19 reductions in business activity have left many policyholders seeking sources of cash. As such, many policyholders have already been actively requesting premium returns from carriers for reduced exposures.[5] This is also increasing customer touchpoints with carriers and agencies at a time when much of the insurance workforce has transitioned to work-from-home environments, which presents other challenges. As mandated by certain states, such as New York, carriers have also been implementing a premium moratorium where they will not cancel policies for missed premium payments.[6]

The federal stimulus bill could potentially limit the speed at which policyholders return operations to normal, assuming a quick national economic recovery, as some unemployed workers may delay seeking employment for up to four months as they collect unemployment benefits. Ultimately, the magnitude of lost premium income will likely depend on the speed and vigor of the recovery, which may vary by industry and extend from only a few months to years.

Frequency considerations by industry

Different industries are experiencing contrary levels of workers' comp activity as the United States shifts from an active society to one of partial hibernation in an effort to combat the COVID-19 pandemic. Specifically, healthcare, grocery retail and distribution, certain online retailers, manufacturers of medical equipment, and restaurant delivery industries, as well as those who employ first responders, are likely experiencing increased claim and exposure activity. On the other hand, most other industries are experiencing a reduction in activity.

During prior economic downturns, many workers' comp carriers experienced an increase in claim frequency (i.e., the number of claims divided by premium or payroll) in what otherwise had been a continuous decline. Workers' comp claims may have been filed as a substitute for unemployment insurance, as some workers worried about loss of employment. With COVID-19, unlike prior economic downturns, the temporary shutdown of much of the economy and shift to work at home may result in fewer workers' comp claims while increasing the potential for claims arising from gray areas for nonessential COVID-19 industries.

Many workers are now unemployed, idle, or working in a home environment performing less risky tasks in a more familiar setting. While injuries that occur at home out of the course of employment may likely be covered by workers' comp, distinguishing between work-related and non-work-related injuries may prove to be difficult. The risk of work-related auto accident injuries has also been reduced, not just for those who are idle and working from home, but for those who continue to operate vehicles during employment as traffic congestion has nearly disappeared.

The frequency of workers' comp claims may increase for industries experiencing growth and/or operational changes. Specifically, the hiring of new inexperienced workers, more congested healthcare environments, changes in daily responsibilities, and a shift to manufacturing of medical supplies through new, unfamiliar, and possibly less automated processes may all lead to a higher rate of workers' comp claims. Further, the potential exists for an increase in fatigue-related trucking accidents associated with the shipment of goods in support of the fight against COVID-19. The increase in demand for supplies required to mitigate the COVID-19 outbreak and treat patients led the Federal Motor Carrier Safety Administration to suspend a 1938 road safety law that limits the number of hours a truck driver may work.[7]

Individuals who contract COVID-19 may be eligible for workers' comp benefits in certain states depending on statute, profession, and interpretation of the contraction of COVID-19 as an occupation disease or an ordinary life disease. Occupation diseases contracted through the course of employment are typically covered while normal illnesses that impact all of society are not. However, there is a growing sentiment that first responders and healthcare professionals will receive workers' comp benefits if they contract COVID-19. Currently, per a Washington State Department of Labor and Industries news release, coverage will be provided to first responders and healthcare professionals who contract COVID-19 or are in quarantine.[8] In addition, at least one other carrier has publicly stated that it will also provide benefits to quarantined first responders and healthcare professionals.

First responders and healthcare professionals are particularly vulnerable given the constant exposure to the virus and current shortage of medical personal protective equipment (PPE). Currently, given staffing constraints, healthcare professionals in certain states could potentially face a greater risk of spreading COVID-19 to other professionals, as they are not required to self-quarantine if they have been in contact with an infected individual unless they show signs of symptoms. In addition to possibly contracting COVID-19, first responders and healthcare professionals may experience Post Traumatic Stress Disorder (PTSD) from experiences treating COVID-19 patients. Certain states already allow for PTSD claims for first responders and other professions that may experience traumatic incidents.[9]

Cost uncertainty

COVID-19 also introduces uncertainty regarding the average cost of workers' comp claims. During prior economic downturns, some carriers experienced an increase in the number of lost time days per claim as injured workers received continued workers' comp benefits instead of normal wages. Instances of some employers delaying return to work dates for existing injured employees are likely already occurring with COVID-19.

The burden of COVID-19 on the healthcare profession and the implementation of social distancing in treatment (via telemedicine and virtual physical therapy, for example) may impact the ability to rehabilitate injured workers. At the same time, many insurance carrier claim professionals have been transitioning to a work-from-home environment. Further, many elective surgeries associated to work-related joint and back injuries are possibly being delayed due to the risk of virus spread. In the short term, this will likely decrease workers' comp medical payments while increasing wage replacement benefits and pharmaceutical costs. In addition to shifting the medical payments to later dates, delaying surgeries and other remedies may increase the risk of future medical complications. Claim cost uncertainty is also introduced to those injured workers who may contract COVID-19. Lastly, in states where settlements of workers' comp claims are permitted, there may be an increase in the willingness of injured workers to settle.

Overall considerations

Workers' comp carriers will likely see many effects from COVID-19 with varying impacts that actuaries should strive to understand and consider in their analyses. For instance, actuaries may consider reviewing data analytics or performing separate analyses for certain industries, states, and types of medical costs (i.e., pharmaceutical, surgical, hospital, doctor, rehab, etc.).

Actuaries may also need to be wary of how any potential slowdown of medical payments, lengthening of lost-time claims, and changes in settlement activity may impact analyses as well as premium refunds on expected loss ratios/rates.

Medical malpractice

Tremendous pressure could translate to increased frequency/severity

Medical malpractice is anticipated to be another coverage highly affected by COVID-19 in the United States. While there will potentially be a short-term decrease in claims as some medical procedures are stopped in anticipation of the rush of patients needing COVID-19 treatment, there is the potential for adverse frequency and severity claim trends as COVID-19 cases flood hospitals, with a few caveats to consider. The potential of COVID-19 malpractice claims could stem from failure to diagnose and/or providing inappropriate medical care.

The COVID-19 pandemic has generated an exponential rise in treatment of infected individuals. As hospitals or healthcare providers reach capacity, some professionals are beginning to work out of their area of expertise, being called out of retirement, and working in different geographic locations. This may increase uncertainty with both malpractice coverage and allegations. Further uncertainty may also exist given nearly a third of US physicians were age 60 and over as of 2016,[10] and therefore fall in the COVID-19 at-risk population.

Due to the limited availability of healthcare professionals and the recommended level of social distancing and lock-downs, many in the general population outside of "at risk" groups have been encouraged by federal, state, and local governments to delay less essential medical care. This can complicate future non-COVID-19 medical care and potentially increase the risk of additional malpractice claims.

According to a study from China, published by The Lancet in February 2020, over 13 percent of the patients hospitalized with COVID-19 developed a hospital-acquired infection, which was observed to be greater among people with respiratory problems and could be due to overcrowded facilities during the surge of cases or the result of overworked professionals.[11] This is another increased risk for medical malpractice allegations.

Many US healthcare providers have been experiencing a massive shortage of surgical masks and ventilators. While this may be claimed as a hospital system's lack of preparedness for a pandemic, it's difficult to allege that a hospital is not meeting preparedness standards if many hospitals are equally unprepared.

On the other hand, certain states, such as Illinois, have already moved to grant healthcare professionals immunity from civil liabilities for action taken in good faith, which could reduce claims propensity from COVID-19 related treatment disputes.[12] In addition, some insurance carriers are providing coverage to retired policyholders free of charge to those being called to practice.[13]

Overall considerations
Given the hardening of the medical malpractice market across some jurisdictions, many insurers have generally struggled to make a profit in this line of business for several years. With the potential for an increase in losses due to COVID-19 related issues, insurers should think about their upcoming pricing strategies given the competitive market conditions.

Additionally, the increased demand for attorneys may correspond to higher incurred expenses and an overall adverse impact on losses. Recent market trends reflect a longer holding period for plaintiffs, as most are willing to wait for more money. In this case, the trend may actually reverse—the contraction of the economy and spike in unemployment rates could cause plaintiffs to seek settlement more immediately, effectively injecting cash to their clients in the midst of macroeconomic turmoil.

As actuaries approach reserving and pricing analyses, it will be important to incorporate time for meaningful dialogue with business partners in the claims and underwriting departments to understand the pace and nature of claims emergence, legal strategies, and underwriting actions.

Business interruption

Covered, not covered, or federally backed?

The impact of COVID-19 on business interruption claims will depend in large part on policy wording, but this area has the potential to be further affected by legislative changes and court rulings.

Most standard business interruption policies contain exclusions for viral epidemics and require physical damage to property for coverage to apply. This was implemented by the Insurance Services Office (ISO) in 2006 as a result of the Severe Acute Respiratory Syndrome (SARS).[14] Barring any legislative changes or adverse court rulings, insurers that adopted ISO's policy forms or have other clear exclusions for communicable diseases should not expect to pay claims related to COVID-19. However, specialty insurers and manuscript policies for large insureds who do not have clearly defined exclusions in their policies may be exposed to claims for COVID-19 related business interruption.

Regardless of whether COVID-19 is covered by the policy, it is likely that numerous claims will arise, and some policyholders might take their insurer to court. One lawsuit making headlines was filed by a Louisiana restaurant against their business interruption insurer, alleging that the virus is physical damage to their countertops, and therefore claims arising from this damage to physical property should be covered.[15] As of this report's publication date, the Louisiana courts had not decided on this case. However, even without claim payouts, business interruption expenses are likely to increase due to an influx of claims and the legal costs in the event of a lawsuit.

There is also the potential for legislative changes to expand business interruption coverage. Currently, certain states are requiring insurance carriers to provide data on business interruption coverage written. On March 16, New Jersey was the first state to introduce a bill that would require in-force policies to provide business interruption coverage for global virus transmission or pandemics for small businesses with less than 100 employees, regardless of any policy exclusions to the contrary.[16] Currently, Louisiana, Massachusetts, New York, Ohio, and Pennsylvania have introduced similar bills.

Overall considerations

Standard business interruption policies should not be impacted by COVID-19 unless legislation is passed or court rulings are handed down that effectively nullify or change policy definitions. Regardless of such coverage decisions, insurance carriers can expect to experience an increase in administrative expenses from responding to state inquiries or data calls as well as claim-related expenses as policyholders file an unprecedented number of claims and potential lawsuits. This would lead to an increased emphasis in setting new frequency and expense assumptions in actuarial analysis. For example, actuaries may choose to refine how claims information is segmented to study frequency and severity trends.

From a pricing perspective, besides increased expenses and disruptions to claims reporting patterns, additional uncertainty exists related to how pandemic risks such as COVID-19 will be handled going forward given the expected uptick in demand for insurance coverage in the future. Ultimately, some expect that future business interruption policies may provide coverage for pandemics when a government requires closure of nonessential businesses, with a federal backstop limiting industry-wide and individual carrier exposure similar to the Terrorism Risk Insurance Act (TRIA) program. Such a proactive government-backed program may provide more economic stability by injecting cash to businesses to address loss of income faster, through policyholder-insurer relationships, than the retroactive nature of a federal stimulus. This may allow for businesses to continue to provide payroll to employees, reducing the burden on unemployment insurance and the need for certain aspects of stimulus bills.

Actuaries may need to work through pricing scenarios for different product and underwriting strategies as the marketplace evolves, such as products where pandemic risk continues to be carved out versus those specifically designed to include affirmative pandemic risk coverage options.

Auto insurance

Lower personal and commercial frequency

COVID-19's effect on individuals, communities, and organizations is enormous and continually developing. Some impacts are more near-term and visible, while others will likely still be felt and explored for years to come. As schools close, employers shift to work from home, and group events are cancelled in attempts to stem the spread of the virus, roads and highways have seen a reduction in vehicles. US carriers that write auto insurance will see dramatic shifts in business experience.

The immediate impact seen by the insurance industry in the auto sector is regarding the frequency of driving-related claims. One of the most predictive characteristics of a policyholder's likelihood of an accident is the number of miles driven. As people have adjusted to social distancing and working remotely, many vehicles are left sitting in driveways, parking lots, and garages. Significant reduction in traffic density for individuals who are operating vehicles further reduces claim frequency, as road environments are safer with fewer vehicles.

On the other hand, as discussed in the workers' comp section above, an increase in fatigue-related claims associated with commercial vehicle operators driving for longer periods to meet COVID-19 related demands in certain industries may potentially offset some of the expected frequency reductions. The longer the quarantines last, the larger the frequency reduction impact for insurance carriers. Carriers with telematics technology may be able to observe the drop-off in vehicle usage more quickly.

The impact on auto claim frequency from the COVID-19 pandemic may extend beyond the completion of the government quarantine period, due to possible changes in societal behavior and business practices. Much of society has already been in a transition with an increasing percentage of employees working from home, purchasing goods online, and streaming video entertainment. A significant speedup in this transition may now occur as some businesses and individuals may not revert to routines prior to the COVID-19 outbreak. This may suppress miles driven while also possibly resulting in higher unemployment. Contrarily, persistency of lower gasoline prices may increase driving demand.

COVID-19 may impact average auto claim costs in both directions. Average costs associated with new accidents may decline with less traffic density. With fewer vehicles on the road, the average number of vehicles involved in an accident will likely decrease. Conversely, average repair costs may be adversely impacted from a potential disruption in the supply chain of vehicle parts. Replacement part costs may escalate from a supply shortage, as vehicle part manufacturers and their suppliers have reduced operations. This may be further exacerbated when quarantines are lifted and owners begin servicing vehicles that would have otherwise already been serviced.

Auto insurers may experience a slowdown in claim closures for both physical damage and bodily injury. Vehicle repairs are likely delayed with many service providers in an idle state. For bodily injury, delays are expected to occur with medical procedures, physical therapy treatments, and legal/court proceedings. Similar to workers' comp, delaying medical procedures and other remedies may also increase the risk of future medical complication and costs that will pass on to auto insurance carriers.

Insurers, particularly those that write nonstandard business, may also expect to see a reduction in average policy premiums as policyholders potentially reduce coverage to save money given current economic uncertainty. Specifically, policyholders may reduce limits, increase deductibles, and/or remove vehicles from policies.

Auto insurance companies must also consider the potential of reputational risk during the COVID-19 pandemic. Regulators have already received calls from consumer watch groups to reassess insurance carrier profitability levels that will likely result from a reduction in claims. This provides insurance carriers with an opportunity to improve or maintain their reputation, or potentially risk seeing it deteriorate within the market. Many insurers have paused cancellations for nonpayment of premium and have announced COVID-19 reduced exposure rebates determined as a credit per vehicle or a percentage of future premium on existing or renewal policies.[17]

Overall considerations

In performing auto claim analyses, actuaries may want to consider frequency-severity methodologies and separate analysis by geography (city, county, state), coverage, and industry. Depending on the length of quarantines, accident quarter or accident month analyses may also provide additional insights into changes in frequency, average costs, and claim closure activity.

It may also be important for actuaries to understand the accounting treatment of COVID-19 reduced exposure rebates and the implication on loss ratios and post-pandemic rate filings.

General liability

Impacts will vary by type of business

The effects of COVID-19 on general liability insurance will vary by industry. Premises-related general liability claims are expected to decrease significantly for nonessential businesses, such as retailers and hospitality (restaurants, bars, hotels) while general liability claims may increase for essential businesses (such as supermarkets, pharmacies, and box stores, as well as online retailers). Many essential businesses are experiencing an increase in demand for food, personal sanitation, cleaning, and other critical supplies, leading to heavier foot traffic and higher sales.

COVID-19 general liability claims may occur from customers claiming that they contracted the virus from a business' operations, premises, or products. Another potential claims risk is from individuals who contracted COVID-19 while attending insured-sponsored gatherings in excess of government mandates. Although such claims may be difficult to prove, general liability insurers may experience an increase in expenses to defend policyholders.

Similar to auto liability, general liability carriers may experience a slowdown in claim closures and an increase in settlement costs that might result from delays in medical procedures, physical therapy treatments, and legal/court proceedings. On the other hand, claimants may be more willing to settle claims to replace other loss of income.

Overall considerations
Actuaries may want to consider evaluating analytics and performing analyses separately for certain industries and geographies, as well as consider potential changes in settlement activity, frequency, and severity trends.

Similar to other casualty lines, as actuaries approach reserving and pricing analyses it will be important to incorporate time for meaningful dialogue with business partners in the claims and underwriting departments to understand the pace and nature of claims emergence, legal strategies, and underwriting actions.

Travel insurance

Will travel insurance be used, with airlines/hotels offering refunds and vouchers?

The impact on travel insurance depends on the type of policy and the fact that most standard travel insurance policies do not provide coverage for "foreseen events." Some travel policies may take this further and specifically exclude coverage for travel issues related to pandemics, whether "foreseeable" or not. However, some travel insurers may provide coverage in certain situations related to COVID-19, such as for those travelers who contract COVID-19 or those who planned to travel to countries most impacted by COVID-19 during certain time periods. In addition, travel insurance policies that allow the customer to purchase "cancel for any reason" add-on coverage may provide partial protection for trip cancel for any reason related to COVID-19.

Financial losses to individuals from travel cancellations related to COVID-19 are also being minimized through the removal of cancellation and change fees, as well as credits and refunds by airlines, hotels, and other hospitality companies. This helps to reduce pressure on travel insurance carriers when individuals' financial losses can be mitigated through other channels.

Overall considerations
Travel insurance companies are experiencing an increase in claim activity, which is expected to dissipate, along with new travel policies and premiums. Actuaries conducting travel insurance reserving analyses may need to adjust for more extended claims emergence and payment patterns, particularly if a higher than normal percentage of claims are disputed.

In the longer term, after the world heals from COVID-19 and the travel industry begins to recover, there will likely be an evolution in travel insurance policies and the "cancel for any reason" add-on coverage that will need actuarial pricing expertise.

Surety bonds

Time will tell

Many construction companies have reduced construction activity with government restrictions on nonessential business to contain the spread of COVID-19. For construction projects that continue, project delays are also occurring as some employees have also decided not to work out of concern of contracting COVID-19. This will likely cause delays in project completions and increase expenditures for equipment (cranes, forklifts, and other machinery), which is often rented, and other items.

Costs associated with completion delays may pass to insurance companies through surety bonds, depending on contract terms. However, the overall impact of COVID-19 on surety bond claims is currently unknown. Most surety bonds contracts include a force majeure clause that excludes a party's performance from uncontrollable events—a standard that COVID-19 may or may not meet. Overall, insurers may expect an increase in surety claim activity that will at least lead to an increase in expenses.

Construction companies are also likely experiencing a decrease in income from delays in new project starts and reductions in sales of existing projects (houses, condominiums, etc.). This may lead to bankruptcies of some construction companies, similar to what occurred during the prior economic downturn, which may impact future insurance carrier premiums in surety and other lines of business.

Overall considerations
Companies that provide a broad suite of coverages to the construction industry may find it useful to more directly communicate across organizational siloes to understand the varying impacts of COVID-19 on lines of business, such as property, liability, inland marine, and surety.

Directors and officers

Stock market volatility and SEC intervention pave the way for more claims

History tells us that any event in which a company's market value decreases could lead to directors and officers (D&O) claims, and the COVID-19 outbreak is likely no different. Executives are acting swiftly to keep up with the latest public health recommendations, such as closing offices and shutting stores, but the situation changes regularly. The US Securities and Exchange Commission (SEC) has already ordered publicly traded companies to file disclosures detailing COVID-19's impact on their operations.

Companies have been faced with many difficult decisions in recent weeks. Questions about when and where to close stores and the feasibility of employees working from home are just a few conundrums on the minds of executives as the disease continues to spread. The way in which companies respond to these challenges could be the basis of future lawsuits. Were they unnecessarily cautious? Did they not do enough? Did they act too soon, or was their response too slow?

The SEC disclosures could directly impact a company's share price, and the risk is that a company's response plan or revised forecast may no longer be feasible just days after publishing, depending on how the situation develops. If a company then has to revise a plan or forecast, which negatively impacts the share price, would the original disclosure be a wrongful act?

Overall considerations

Time will tell which actions and strategies were correct, and ultimately it may be up to the courts to determine if any of the COVID-19 related market value decreases are the fault of directors and officers. Regardless, it is likely that COVID-19 related D&O claims may arise and insurance companies, at a minimum, will see additional expenses to defend these potential claims.

Similar to other casualty lines, as actuaries approach reserving and pricing analyses it will be important to incorporate time for meaningful dialogue with business partners in claims and underwriting to understand the pace and nature of claims emergence, legal strategies, and underwriting actions.

Cyber insurance

Exposures expand with shift to remote workforce, rise in COVID-19 related online attacks

Cyber insurance has expanded over the past decade, both in terms of sales of stand-alone policies, as well as inclusion in standard coverages. Most larger organizations, government entities, and companies operating in higher-hazard industry sectors have cyber insurance coverage in place. Growth has been slower than projected for midsize and smaller businesses, primarily from limited policyholder knowledge of their risks and understanding of coverage options or relative pricing.

Given the effects of COVID-19 and the shift toward virtual work environments across the globe, there is increased exposure to cyber insurance losses. Many companies have frameworks in place or are mobilizing to establish protective measures, such as setting up virtual private networks for employee computers enabled via home internet connections. Those who don't are likely getting a rapid education in cyber risk management.

In this transitional period, cyber insurance carriers should be prepared for a potential increase in claims, driven by a higher volume of professionals working from home and unprecedented stress on tools, systems, and infrastructure supporting virtual work environments. This creates an environment for increased cyber risk, as hackers can take advantage of vulnerabilities and ramp up data breaches, COVID-19-specific phishing, ransom attacks, or other disruptions.

Overall considerations

In the long term, the transition to virtual workspaces resulting from COVID-19 may increase the demand for cyber insurance and further the evolution of cyber insurance products. Actuaries will need to continue to hone pricing approaches, and work closely with underwriters and other business partners to understand the cyber risk landscape.

Conclusion

The economic and societal shifts experienced during the COVID-19 pandemic will likely continue to impact the P&C insurance industry moving forward, whether it is through government-backed pandemic insurance, rebates, disruptions to exposure and cost trends, or new interpretations of coverage language.

In the near future, if not already, actuaries will likely be asked to lead efforts in quantifying the financial impact of COVID-19 for their company and clients. Actuaries should consider both the microeconomic and macroeconomic effects of COVID-19 when pricing and reserving, and anticipate the need to reorganize segmentations, utilize techniques that account for changing frequency/severity trends, and closure patterns. Actuaries should also think critically about the implications of COVID-19 on new and renewal business.

If you have any questions regarding this article or if you would like us to help you better understand the impacts to your organization, please reach out to the team below.

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