The Effect of Covid-19 on the Insurance Industry and Insurance Companies’ Strategic Consequences

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The International Center for Insurance Regulation (ICIR)

Located at the Goethe University Frankfurt, Germany, the ICIR is an independent research center with an international and interdisciplinary approach for INSURANCE ECONOMICS and INSURANCE REGULATION with its three missions: Research, (Executive) Education and Policy Platform.
Covid-19 Pandemic Mega-Topic of 2020

- Nearly 1 million **deaths** by 19 September 2020
- **Economic downturn**
- But also **chances**: digitalization, home office, less business trips
- Covid-19 pandemic **affecting the insurance industry**
- Try to **derive strategic consequences**
- Structure my presentation (in principle) according to an **insurer’s balance sheet**:
  - Liability side
  - Asset side
Oliver Bäte
Chief Executive Officer of Allianz SE

“The pandemic continues to be a challenge for all industries. Nevertheless, Allianz has achieved robust results and shown a remarkable resilience in the first six months of 2020. It makes us confident that we will see a solid financial performance also in the second half of 2020.”
“Munich Re will emerge from this crisis economically stronger. We are growing profitably, while taking steps to benefit from the significantly improved market conditions for reinsurers. ... Prices have risen in nine consecutive renewal rounds, and premium income has grown correspondingly. With our high-quality portfolio, we expect to post a premium volume of €54bn in 2020 – which would set a new record in the 140-year history of Munich Re.”
Covid-19 and the Insurance Industry

- Insurers and reinsurers hit hard by the crisis
- Payment obligations not ultimately clarified
- Indirect consequences hard to predict
- But, seemingly, no existential threat through Covid-19
- Reasons?
Covid-19 and the Insurance Industry

- Insurance industry **well prepared** for pandemic outbreak
- Covid-19 **no „Black Swan“**
- **Pandemic risks** often **excluded** especially from business interruption insurance contracts
- Reasons?
Reasons for not offering pandemic insurance

• High individual losses

• Losses affect many policyholders at the same time

• Therefore, risk pooling as a risk management tool of insurers hardly effective

• Therefore possibly existentially threatening aggregate losses

• Risk of “double hit”: Also losses on the investment side

• Meltdown of equity capital
Market for pandemic insurance?

- **Insurance premiums** would have to cover
  - Cumulative risk
  - Systematic risk
    (simultaneous insurance and investment losses)
  - Financial distress risk

- **Demand** for pandemic risk insurance given risk adequate premiums?

- Insurance solutions provide **equity capital**
  - Through ordinary insurance contracts
  - Through capital market-oriented solutions
Strategic Consequences

Strategic Consequence #1:
Build up Public-Private Partnerships for Offering Pandemic Insurance
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Build up Public-Private Partnerships for Offering Pandemic Insurance

Strategic Consequence #2 (for policymakers):
Prepare for a new pandemic by setting up or supporting insurance solutions.

These can be private insurance solutions offered by the insurance industry and financially supported by governments, or insurance solutions offered by governments through issuing catastrophe bonds.
Pandemic Insurance through Pandemic Partnership Bonds: A Fully Funded Insurance Solution in a Public Private Partnership

Policy Letter No. 88

Authors: Helmut Gründl, Fabian Regele

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Abstract: This Policy Letter outlines a pandemic insurance solution through a pandemic-related “Insurance Linked Bond”. It would be originated by governments, with a principal amount to cover significant costs resulting from a pandemic. These bonds, which would be traded on a secondary market, generate a risk-adequate return for private and institutional investors that is financed through the insurance premiums paid by the public domain. In case of a pre-defined pandemic trigger event, the principal of the bond becomes available for the originating governments to cover pandemic-related costs. Through this approach, governments can insure themselves against future pandemic-related risks, while funding comes primarily from private and institutional investors.
Strategic Consequences

Strategic Consequence #3:
Become more transparent and improve communication with policyholders as to the (pandemic) risks covered in insurance contracts.
Strategic Consequences

Strategic Consequence #4:
See the competitive advantages of building up trust through generous claims handling.
Strategic Consequences

Strategic Consequence #5:
Develop integrated risk management concepts for coping with pandemic risks.

This may spread over to other kinds of risks.
Consequences for the Asset Side

### MXAP:IND
MSCI AC Asia Pacific Index

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
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</thead>
<tbody>
<tr>
<td><strong>OPEN</strong></td>
<td>173.24</td>
</tr>
<tr>
<td><strong>YTD RETURN</strong></td>
<td>1.90%</td>
</tr>
<tr>
<td><strong>PREV CLOSE</strong></td>
<td>173.07</td>
</tr>
<tr>
<td><strong>DAY RANGE</strong></td>
<td>172.80 - 174.07</td>
</tr>
<tr>
<td><strong>1 YEAR RETURN</strong></td>
<td>12.14%</td>
</tr>
<tr>
<td><strong>52 WEEK RANGE</strong></td>
<td>121.18 - 175.90</td>
</tr>
</tbody>
</table>

### LAPCTRJU:IND
Bloomberg Barclays Asian Pacific Aggregate Total Return Index Value Unhedged JPY

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPEN</strong></td>
<td>-</td>
</tr>
<tr>
<td><strong>YTD RETURN</strong></td>
<td>-0.44%</td>
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<tr>
<td><strong>PREV CLOSE</strong></td>
<td>153.95</td>
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<tr>
<td><strong>52 WEEK RANGE</strong></td>
<td>151.60 - 156.29</td>
</tr>
<tr>
<td><strong>1 YEAR RETURN</strong></td>
<td>-0.33%</td>
</tr>
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</table>
Consequences for the Asset Side

- **Worldwide decline of stock and bond prices in March 2020**
- **Speedy recovery** of capital markets
- **Long-term indirect effects of Covid-19 on assets?**
  - Restructuring of the economy
  - Fundamental change of investment values, e.g. property prices
Strategic Consequences

Strategic Consequence #6:
Pay attention to the specific exposure of your investment portfolio to direct and indirect Covid-19 effects.

Especially the indirect, long-term effects can induce restructuring of the investment portfolio.
Strategic Consequences
(back to the insurance business)

Strategic Consequence #7:
Pay attention to the specific exposure of your insurance portfolio to indirect and long-term Covid-19 effects.

The sources for economic values added may change due to a change of the business structure in the economy.

Insurers need to be very close to these developments to avoid wrong investment decisions, especially in long-term investments.
Strategic Consequences

- Public debt-financed rescue packages
- A major risk for insurance companies?
- Downgrading may trigger fire sales
Strategic Consequences

Strategic Consequence #8:
Insurers, especially life insurers, should rethink their investments in government bonds in the light of Covid-19-induced increased public debt and subsequent default risk.
Thank you!

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