IRSG

INSURANCE AND REINSURANCE STAKEHOLDER GROUP

Advice on Measures to Improve the Insurability of Business Interruption Risk in Light of Pandemics

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EIOPA STAFF PAPER ON MEASURES TO IMPROVE THE INSURABILITY OF BUSINESS INTERRUPTION RISK IN LIGHT OF PANDEMICS

IRSG WRITTEN COMMENTS

Introduction

The IRSG is supportive of EIOPA efforts to explore ways to improve the insurability of non-damage business interruption risk in light of pandemics. We make the comments below in addition to our original comments contained in EIOPA-IRSG-20-38.

Covid-19 has highlighted the need to address the major protection gap in coverage for pandemic-related business interruption (BI) losses, as evidenced by the estimate shown in paragraph 2 that less than 1% of the estimated global GDP loss for 2020 will be covered by business interruption insurance. With regard to the current COVID-19 pandemic the projected global output losses for the year 2020 alone are estimated to amount to more than USD 4 trillion. Thus, property and casualty insurers would have to collect business interruption policy premiums for 150 years to make up for the projected global output losses in 2020.[1] These losses are caused by lockdown measures introduced by national governments. This poses a key challenge to insuring pandemic-related business interruption losses, given that government interventions cannot be predicted or modelled. Other man-made events causing similar losses, e.g. wars, are historically excluded from insurance cover.

Scope of cover

SMEs and the self-employed are affected by the pandemic to a greater degree on average than other entities. As the EIOPA paper correctly recognises, the effect on SMEs is especially severe for several reasons, including higher levels of vulnerability, lower resilience related to their size, and limited financing and diversification capacity. The data shortages mentioned in the paper also apply disproportionately in the case of SMEs, with particular issues around granularity of available data, differentiation between sectors, size of entities, and local specificities. This extra exposure indicates that impact analysis in relation to solutions should have a significant focus on the impact on SMEs.

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[1] Geneva Association; An Investigation into the Insurability of Pandemic Risk; 26 October 2020

The paper could be better balanced by further elaborating on issues related to access to pandemic-related business interruption (BI) insurance products for the most vulnerable parts of SMEs, mainly the micro and small enterprises. Micro and small enterprises account for more than 90% of the total number of enterprises in the EU, are the most affected by pandemic events, do not have the means of taking risk prevention measures, and would most probably find it difficult to afford such products.

The paper chooses to highlight and elaborate on the issues of the role of capital markets and on the multi-peril pooling approach. Both issues are important and are worth exploring, but, since the core issue in question is Business Interruption, the paper should primarily focus on how businesses, as the end users/the clients of these products could get better access to such a product, so that the product itself could be first initiated and distributed. In this context, issues like raising awareness of, improving access to, and creating monitoring and evaluating mechanisms for a Business Interruption product offered to businesses, and most importantly, small businesses, should either be elaborated further in the paper, or at least be better spread across the analysis of the paper.

National initiatives

We note that preliminary national initiatives to cover future pandemic risks are currently underway in France and Germany. These discussions have been characterised by a material financial commitment of the relevant State with the latter acting as the ultimate reinsurer which would to step in to cover losses exceeding a defined threshold.

In June 2020 the French Insurance Federation (FFA) presented a concept for a national insurance solution (CATEX), a public-private multi-peril solution for exceptional disasters (*catastrophe exceptionnelle*), including private (re)insurers and the French public reinsurer *Caisse Centrale de Réassurance* (CCR), which is State-owned and would provide the “backstop”. This was one of four pathways which were considered. This route will not now be proceeded with, as the setting up of a new insurance regime through a public-private partnership was discontinued in December 2020. There will not be a mandatory pandemic insurance in France, but there will be the option for all those who wish to do so to build up provisions which will benefit from an advantageous tax regime, allowing money to be put aside in good times to be used if a new pandemic was to occur.

The *Gesamtverband der Deutschen Versicherungswirtschaft e.V.* (GDV) suggested a four-layer insurance solution for State imposed lockdowns following pandemics including private (re)insurers, the capital market and the State as ultimate reinsurer.[2]

[2] pandemiefonds-vorschlag-download-green-paper-data.pdf (gdv.de)

We note that a plan to encourage business recovery can also include public/private fund(s) targeted at providing capital support for enterprises which are struggling under the impact of Covid-19, and that this should be part of a package to address business interruption. A specific example of this has been launched in Ireland, backed by the Ireland Strategic Investment Fund Pandemic Stabilisation and Recovery Fund, and intends to provide "patient capital" to SMEs in the form of debt on commercial terms.

Modelling and data

Limitations in relation to modelling and data are mentioned in relation to all areas covered in the paper. Substantive progress on constructive solutions is likely to be very slow in the absence of material steps forward in these areas. The IRSG considers that EIOPA should investigate the possibility of bringing expert modelling resources together from inside and outside the industry in order to improve the predictive quality of available models. This work would have applicability beyond insurance, could be enabled by a public/private partnership approach, and should be made openly available.

We also previously noted that lack of data is a particular issue for SMEs.

Prevention measures

Prevention is a key step to reduce the impact of future pandemics and other systemic events. Insurers can play a role in prevention but the IRSG stresses that the paramount role in prevention is that of government.

Good risk management has an important role to play in mitigating costs associated with such events. We note that individuals and businesses have different possibilities for taking risk prevention measures depending on their sector, size or financial capacity. This suggests that the ultimate approaches taken to prevention must recognise these differences and be proportionate in their implementation.

We agree that clarity of sources of loss and clear communication of product features are important in encouraging effective risk management.

The paper highlights the problem of affordability of insurance among vulnerable parts of society. Prevention will equally create a greater relative burden for vulnerable parts of society, and these elements need particular attention in any solution.

Capital markets

We agree that claims resulting from pandemics cannot provide diversification in the same way as instruments linked to natural catastrophes. Claims resulting from pandemics can occur worldwide, in high numbers, and at the same time. There can also as mentioned be a clear correlation between pandemics and market risk. This is likely to limit the market for capital market instruments based on incidence of pandemic alone. The difficulty of identifying objective and relevant parametric triggers is likely to be another limitation.

Multi-peril pooling

The IRSG agrees with EIOPA that there is merit in exploring a multi-peril approach, which could enable benefitting from diversification and potentially increasing capacity. However, the multi-peril approach will be difficult to implement from a technical point of view (e.g. complexity, bundling different types of risks, investor preferences) in the short term, and this may be more a medium term option.

It is also important to note that future crises are unlikely to take the exact same shape as the current crisis and it would be unwise to assume that the same issue will apply in the same way for future events. Insurance or capital market instruments which are too limited in their coverage may risk being of little use in future systemic events.