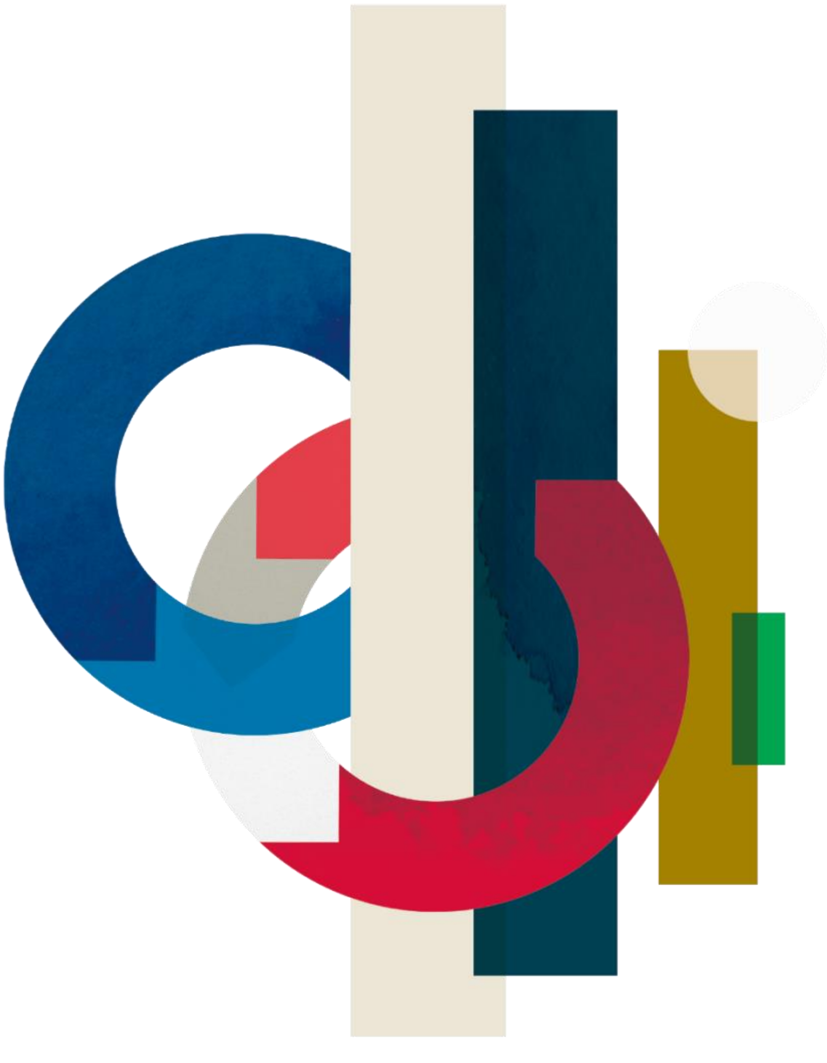
Emerging Risks in Insurance Underwriting Policies in Europe



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Context

Existing risk assumptions, assessments and management approaches are constantly changing due to the effects of natural environment, technologies, and socio-political landscape development. ESG-related risks that were once considered as "emerging" (such as the pandemic, cyber security, biodiversity loss and climate change) are now recognised as critical issues by the international community because of their impact on business continuity and companies' performance. They are now consistently included in the top risk factors as defined by the World Economic Forum´s Global Risk Reports[1], and could be leading to widespread fatalities and economic disruption.

Given the nature of their activities, companies within the **insurance sector** are required to keep up with and master these emerging risks, especially those related to the impacts of COVID-19. Similarly, Moody's reports that the industry recognizes the potential for ESG issues to affect insurance underwriting outcomes[2]. On the other hand, the pandemic is testing the capabilities of the insurance sector to manage pay outs to customers as well as the health of their own investment activities. Lloyd's of London have estimated that the COVID-19 pandemic will cost the insurance industry more than USD 200bn[3]: Just over half of their estimated losses relate to claims with insurers expected to pay out for events cancellation, business interruption and trade credit cover. The additional USD 96bn represents investment losses, where the turmoil in financial markets is impacting the value of the asset's insurers hold to fund claims. Ultimately, demonstrating preparedness to tackle emerging risks is an indicator of resilience.

Within the assessments of the insurance sector, Vigeo Eiris analyses how these companies factor emerging risks into their service offering. This Sustainability-Focused analysis provides an overview of the European landscape.

1 The Global Risks Report 2020, World Economic Forum, January 2020
2 The impact of environmental, social and governance risks on insurance ratings, July 2019
3 Coronavirus to cost insurers more than $200bn" – The Financial Times – 14/05/2020

Key Findings

Within the Insurance sector, Vigeo Eiris assesses three elements related to emerging risks; first, companies' commitments to addressing these emerging risks; second, the reported investments dedicated to research on emerging risks; and third, the provision of insurance policies covering them. Within our 2019 - 2020 assessment of European Insurance sector[4]:

- **41%** of companies reported on commitments addressing emerging risks,
- **29%** reported to have established policies covering emerging risks. Those policies typically cover the issues of cyber-security, demographic changes (ageing populations) and climate change.
- **52%** reported on investments in research on emerging risks. These were typically undertaken with a dedicated department and with stakeholder dialogue through initiatives such as the CRO Forum, which brings together Chief Risk Officers in order to develop industry best practices in risk management.

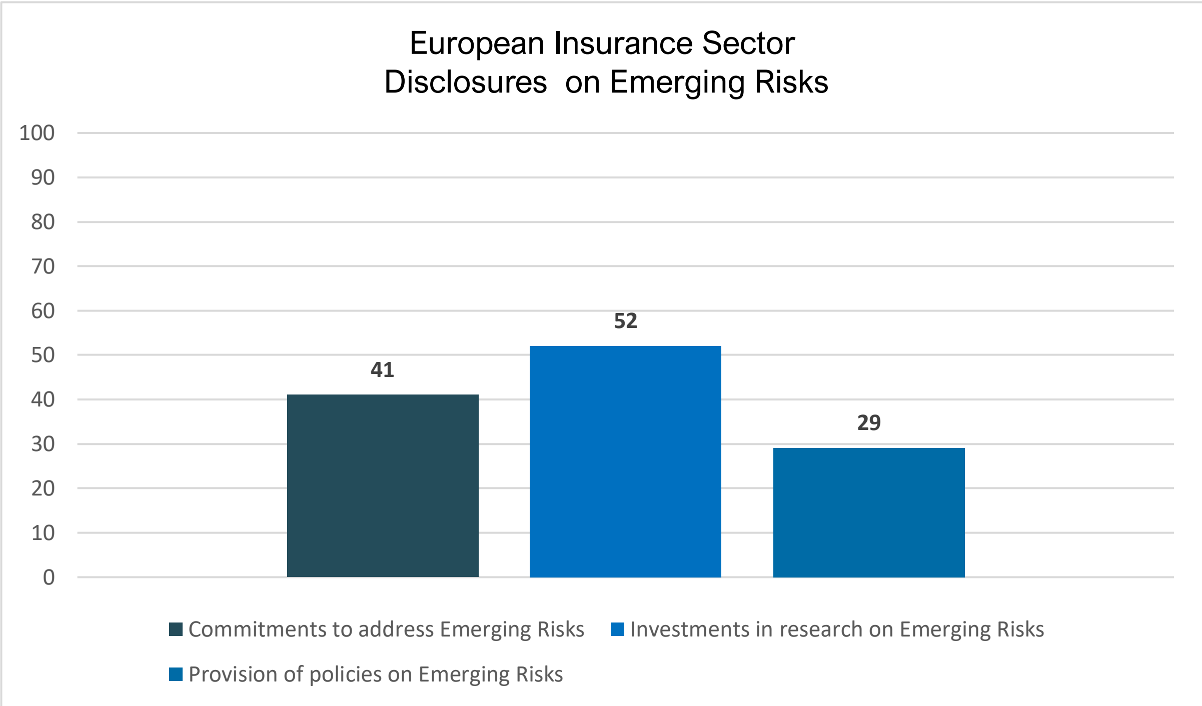

Figure 1: Vigeo Eiris' assessment of European Insurers and their reported integration of emerging risks. All figures reflect the percentage of companies within the sector (out of 48 companies) disclosing information on these angles.

4 Vigeo Eiris' assessment of the European Insurance sector (for the financial years 2019 and 2020) covered 48 companies.

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Analysis

These weak figures are indicative of a lack of preparation and/or transparency at sector level. Industry initiatives such as the CRO forum[5] (launched in 2005) do appear to be trying to raise awareness and stimulate action on emerging risks and involve a number of the larger European insurance companies**.** The question is why some of these emerging risks, including but not limited to pandemics, are not included in most standard business insurance policies?

The answer likely lies in the difficult measurement of their related risks. All insurance policies have exclusions of coverage for risks that are too great to be underwritten at an affordable price or lack historical data sufficient to make predictions[6]. Aside from parametric insurances (an index-based insurance bypassing the uncertainty in pandemic risk by covering the probability of a predefined event), global pandemics like COVID-19 usually fall into this uncertain and less predictable category[7]. This makes them highly unattractive to any insurer.

RiskGenius, a technology-assisted review of insurances policies raised the notion of the "Silent COVID Coverage Issue". They estimated that 80% of commercial policies do not contain a clear inclusion or exclusion for communicable diseases. Thus, these policies could be read as being "silent" on whether or not communicable diseases would be covered**.** This silent threat could be especially damaging for more vulnerable enterprises. Business interruption losses from the coronavirus for small business in the U.S. are forecast to amount to USD 220-383 billion per month with a potential 30 million claims, according to the American Property Casualty Insurance Association[8].

Best Practices

Vigeo Eiris research also offers insights on the solutions provided by companies. In March 2018, **Munich Re** partnered with the insurance broker Marsh and the infectious disease risk expert Metabiota to create PathogenRX[9], an integrated pandemic risk quantification and insurance solution built to provide financial protection to businesses. The coverage trigger is linked to a Sentiment Index, developed by Metabiota, that gauges public fear and behavioural change in the wake of an epidemic outbreak and provides analytics on infectious diseases. Policyholders are able to model their potential

5 The CRO Forum website, accessed 23/06/2020. The CRO Forum Emerging Risks Initiative consists of ten members (Allianz, AXA, Hannover Re, Lloyds, Munich Re, RSA, Prudential, SCOR, Swiss Re and Zurich Insurance.

6 Maryland Insurance Administration Advisory on Business Interruption Insurance, Maryland Insurance Administration, 18/03/2020

7 Maryland Insurance Administration Advisory on Business Interruption Insurance, Maryland Insurance Administration, 18/03/2020

8 Covid-19 BI losses for small firms could hit $383bn per month, warns APCIA, Reinsurance News , 27/03/2020

9 PathogenRX, An Innovative Solution for Pandemic and Epidemic Risks, Marsh website, accessed 23/06/2020

financial loss and can customize coverage for specific expenses, regions, types of disease or portions of a calendar year.

In 2013, **Swiss Re** developed SONAR[10] ("systematic observation of notions associated with risk"), a group-wide framework specifically designed to manage and communicate on emerging risks. The product included an intranet platform enabling employees to share and discuss risk notions based on developments in the re/insurance landscape, allowing for bottom-up identification and peer reviews. The risk notions – or "early signals" – flagged on SONAR are monitored by Emerging Risk Specialists who periodically cluster and further assess these risk notions for their potential impact on the business[11]. These two cases provide clear examples of how emerging risks can be integrated into the insurance sector.

Conclusion

Within the context of COVID-19, scrutiny over the insurance sector's preparedness for pandemics and other forms of emerging risks has risen. Vigeo Eiris teams have been tracking controversies related to COVID-19, and from the beginning of March through June, a total of 19 cases involving insurance companies have been recorded (13 in Europe, 5 in North America, and 1 in the Asia Pacific region). Vigeo Eiris projects that this number will likely rise as the lockdowns across different regions begin to wind down and more companies pursue insurance claims with their providers. Beyond the impacts of the pandemic, the research on the European sector provides clear indications that companies could do more to strengthen the inclusion and management of emerging risks. Whilst they may be out of the spotlight for now, climate risks, cyber risks and others remain material factors for which preparedness is required. More transparent disclosures will be required from corporates on how they are positioning themselves to tackle these risks.

[10] Sonar, Swiss Re website, accessed 23/06/2020
[11] Sonar, Swiss Re website, accessed 23/06/2020

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