Insurers Can Mitigate Operational Challenges, Losses as Pandemic Claims Mount

Like all major employers, insurance companies are dealing with operational and workforce disruptions, as millions of their employees – adjusters, actuaries, underwriters, and risk and loss control managers, as well as analysts, as examples – adapt to a remote work environment.

The industry's policyholder surplus, invested funds set aside by insurers to pay claims, is under pressure as asset values decline. As of September 30, 2019, the total industry surplus stood at $812 billion, according to the Insurance Information Institute, which warns that this amount could be depleted if insurers are forced (by court order or through legislation) to pay certain pandemic-related claims for which they collected no premium. Additionally, the low interest rate environment is hurting insurers' investment returns, which, combined with underwriting results, are an important component of their overall profitability.

Topping it all off, in their unique role as providers of risk protection products for consumers and businesses of all types, insurers are preparing to field a wide array of costly COVID-19 related claims, which are global and not limited by time. In a call with analysts on April 22, Evan Greenberg, the chief executive officer of Chubb, one of the industry's largest commercial insurers, said he expects the pandemic to spur the "largest single loss in the insurance industry's history."

In this paper, we discuss some insurance coverages most significantly impacted by the pandemic and the actions insurers can take now to begin to mitigate these challenges.

Property & Casualty

The pandemic continues to have a profound impact on the economy, and particularly small businesses. In the United States, thousands of businesses have been forced to suspend operations to protect employees and comply with stay-at-home restrictions. As production, imports, and supply chains grind to a halt, revenues across various industries – notably retail establishments, hospitality, and transportation (particularly airlines and cruise lines) – have been hit especially hard. The American Property

Casualty Insurance Association estimates that collectively small businesses are losing between **$255 billion** and **$431 billion** of income monthly as a result of the pandemic. While various government lending programs are designed to provide businesses with much-needed relief, the proceeds may not be enough to stave off the catastrophic financial losses many face and expect to be covered by insurance.

- **Business Interruption (BI) Insurance** - Many businesses reeling from COVID-19 related revenue losses are likely to file BI claims, which pertain to a type of commercial insurance coverage designed to protect companies from losses due to suspended operations. However, many BI claims are likely to trigger significant legal disputes as many policies require physical loss to a property as a condition for payment, and some specifically exclude viral and communicable infections such as COVID-19.

  The BI lawsuits, which are now being filed against insurers in courts around the country, are most likely to center on whether the physical presence of the virus within a facility or workplace constitutes "physical or property damage." Several states, including New Jersey and Ohio, are pushing legislation to require insurers offering BI coverage to cover losses attributable to COVID-19, essentially acting to nullify the language in business insurance policies.

  In response, insurance industry trade groups have announced they intend to fight these proposed laws, citing that any effort to retroactively mandate insurance coverage for viruses by voiding the exclusions would immediately subject insurers to claim payment liability that threatens their solvency and their ability to make good on actual commitments. Reminiscent of the rush of lawsuits following Hurricane Katrina in 2005, where major claims were disputed over wind-versus-water damage, relative to what was actually covered, COVID-19 claims will likely be heavily litigated for a long time.

- **Workers' Compensation Insurance** – Typically, workers' compensation insurance covers costs associated with workplace injuries or occupational illnesses, like medical expenses and rehabilitation cost. We are already seeing claims from workers who are out for an extended period or have ended up in the hospital after claiming to have gotten sick on the job from the virus.

  Depending on how individual contracts are structured, there may be workers' comp coverage for COVID-19 claims for employees who can prove they contracted the virus on the job. Additionally, several states have enacted legislation and/or issued executive orders mandating workers' comp coverage for COVID-19.

  In California, for instance, at least one insurer is waiving the requirement for essential workers. The State Compensation Insurance Fund, one of the largest workers' comp insurers in the country, has agreed to accept any COVID-19 claim by an essential worker – as defined by the governor in Executive Order N-33-20 – regardless of whether the worker can demonstrate that the virus was contracted during the course of employment.

  As the number of frontline health workers and other first responders getting sick from COVID-19 continues to grow, insurers are likely to see a large spike in workers' comp claims within those occupational groups that have a high probability of on-the-job exposure or have reported a significant increase in infection rate among its workers.

- **Directors and Officers Insurance** – Lawsuits are likely to be filed against directors and officers of companies for actions or inactions, in response to COVID-19, that may have negatively impacted the company. Shareholder groups are most likely to file these claims against the most heavily impacted industries, such as airlines, travel, healthcare, hospitality and retail. The lawsuits implicating directors and officers may allege breaches of duties or misleading disclosures relating to the COVID-19 response, although the success of these claims may be limited if a company took reasonable precautions to protect employees, such as following guidelines provided by the World Health Organization and the Centers for Disease Control and Prevention. Regardless of the merits of the case, insurers may still be on the hook to provide defense costs for D&Os targeted in these lawsuits.

Life Insurance and Annuity

- **General Life Insurance** – Life insurers are facing a wide array of challenges related to COVID-19. The combination of increased mortality rates from virus infections and lower equity prices in all asset lines presents unique challenges for life insurers. The decline in U.S. Treasury rates and the likelihood of a prolonged low rate environment are game changers for the industry, as these are likely to affect insurers' earnings, especially those generated from interest-sensitive or investment-linked products. Also, some carriers are repricing their products or suspending sales of certain long-tail products, given the uncertainties around morbidity and mortality rates and the interest rate volatility. Moody's has already changed the outlook for U.S. life insurers to negative on account of the interest rate dive and warns of possible sizable charges on a GAAP and statutory accounting basis as insurers review the viability of their long-term interest rate assumptions. While insurance rating agency A.M. Best said it believes the life/annuity industry is today more resilient to financial market downturns than it was during the 2008-2009 financial crisis, it expects the current economic conditions to affect the balance sheets of life/annuity insurers more so than those of property-casualty or health insurers.

- **Annuities –** Market volatility and low interest rates also are creating a host of challenges for annuity providers. Since annuity contracts usually are linked to the equity markets, instruments that insurers can buy to back up the guarantees on the contracts are expensive currently. This is likely to impact new business pricing and sales. In a recent regulatory filing, one major annuity provider disclosed the possibility that tracking its investments in this environment will become more difficult if the market turmoil worsens. "Extreme market volatility may leave us unable to react to market events in a prudent manner consistent with our historical investment practices in dealing with more orderly markets," the insurer stated.

Health Insurance

COVID-19 testing and treatment could cost U.S. health insurers up to **$556 billion** over the next two years, according to a report from America's Health Insurance (AHIP). The report estimates that more than 50 million Americans will become infected, with at least 5.5 million requiring hospitalization – of which 1.3 million will require intensive care. Actual outcomes will differ depending on factors such as the number of Americans who become infected but are asymptomatic, the impact of interventions such as social distancing, and the availability of testing.

However, the initial projections could be exceeded if hospital costs surpass the estimates and the average intensive care stays are longer, more expensive or require more services than estimated in the current models. In the longer term, however, the current conditions may drive higher premiums for U.S. health insurers. Also, the millions of unemployed workers who have lost their employer-sponsored health insurance (ESI) means fewer ESI claims going forward but more costly medical expenses for the healthcare system. Given many employees who lose ESI cannot afford to maintain coverage through COBRA, they are likely to delay regular doctor check-ups, which, in turn, could lead to severe hospital and emergency room visits down the line. Additionally, in a cash-strapped economy, individual health plan enrollees are more likely to submit and follow up on claims, compared to periods of financial stability.

Personal Lines Insurance (Auto)

Shelter-in-place and stay-at-home orders have reduced driving significantly, and with fewer drivers on the road, vehicle accidents are down considerably. This turn of events means fewer claims and has prompted many of the major auto carriers to provide insureds with various forms of credit. According to the Insurance Information Institute, auto insurers are expected to return more than **$10 billion** to their customers in the form of refunds, discounts, dividends and credits.

What Insurers Can Do Now

Insurers are responding to the dramatic impacts of the pandemic on earnings and policyholders, and, at the same time, having to address a host of operational challenges, including shutdowns of physical facilities, a remote work environment, lack of access to internal talent, and lower onshore, offshore and third-party staffing levels.

Getting their arms around these operational challenges should be the immediate goal for all insurers. Beyond the early measures of making sure all employees are safe and can perform effectively from their current remote locations, this means working to promptly restore or scale up disrupted services to meet growing customer needs. In this regard, insurers have an opportunity to incorporate agile practices into the insurance underwriting process, which remains heavily dependent on face-to-face sales meetings, paper applications, physical medical examinations, and property appraisals. Any effort toward digitizing and automating these processes, like virtual inspections and damage assessments based on artificial intelligence, will ensure that both new business development and critical COVID-19 response priorities, such as rebate processing, claims and policy administration, are not heavily disrupted.

Given the sheer amount of highly sensitive data they collect and maintain, insurers should also remain vigilant on internal data security and privacy compliance programs. In an environment in which many employees are working remotely, the exposure level for cyber risks remains high. Companies need to assess these risks, including those emanating from third-party vendors and build a plan to enhance data security protocols and monitoring.

Most insurers generally have the capacity to operate in an increased claim environment since that is the nature of their business. However, COVID-19 presents many unknowns that could lead to an unprecedented wave of claims. The biggest unknown remains BI claims that some state governments want insurers to cover. It is important that insurers monitor those state regulatory developments closely and quickly seek legal guidance and advice on complicated business claims as soon as they surface in their claims departments. Resolving those claims early, if possible, would go a long way to reduce uncertainties and disputes.

Keeping an eye on fraud risks (both internally and externally) is critical. In the current work-from-home environment, fraud controls that existed prior to the crisis may not be performed with the same rigor, or, maybe not at all, if they require certain people to be on-site to execute. Management should be asking these key questions: What is our organization doing around internal fraud? How are we making sure we are adjudicating claims with a keen eye on fraud? And, in this volatile market environment, is there a risk of our investment teams circumventing control procedures to increase investment earnings?

We're With You All the Way

As the insurance industry responds to the unprecedented level of disruption caused by COVID-19, Protiviti's experienced team of lending, risk, compliance, technology, cyber, and operations professionals are actively providing solutions that address our clients' immediate and near-term challenges as well as future resilience efforts. Our capabilities include:

- **Resource surge capacity** – Support capacity-strained insurance functions such as rebate processing, loss mitigation and deferral requests, disputes, cyber and data security operations, and other CSR functions, and offer reshoring solutions for finance and/or operations functions.
- **Program governance and oversight** – Establish or help scale up a centralized command center to organize and monitor the insurer's responses to COVID-19 and oversee effectiveness of new programs.
- **Risk and compliance oversight** – Build action plans for pending state legislative actions including updating compliance and documentation requirements, complaint management for disputes and hardship requests. Monitor ongoing process, regulatory, security and privacy risks.
- **Process automation and workflow tool design** – Design and build workflow tools for new programs, such as rebates, or processes, such as dispute decisioning, using Intelligent Process Automation, Robotic Process Automation, Artificial Intelligence, and Machine Learning.
- **Resilience** – Develop strategy and plans for potential next phases of the COVID-19 crisis and other resilience events, leveraging our significant expertise in operational resilience and our industry-tested framework.

Contacts

Michael Pisano
Managing Director
+1.212.708.6353
michael.pisano@protiviti.com

Brennan Warren
Managing Director
+1.312.476.6061
brennan.warren@protiviti.com