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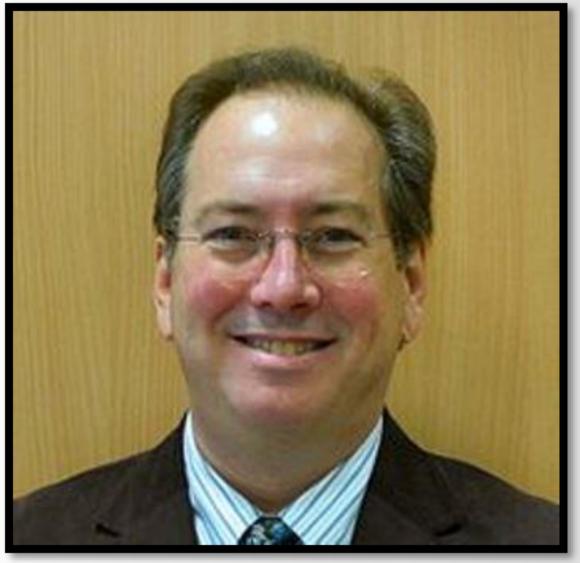
# Insuring The Next Pandemic

**Webinar**

Monday 26 May 2020

# A Word From Our Chairman

FS Club



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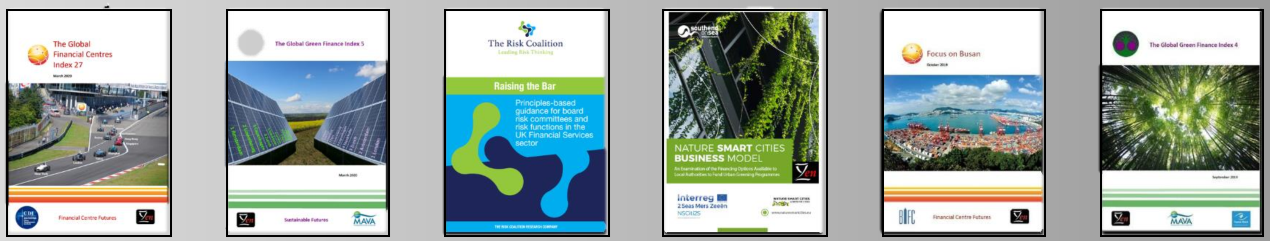

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# Agenda

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| | |
|---|---|
| 10:30 – 10:35 | Chairman’s Introduction |
| 10:35 – 11:00 | Keynote Address |
| 11:00 – 11:15 | Questions & Answers |

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# Insuring The Next Pandemic

**Alistair Milne**

Professor of Financial Economics

Loughborough University

# Insuring the next pandemic

Alistair Milne

FS Club Webinar May 26th, 2020

# Some questions

- Could we have had better insurance in place for Covid-19?
- What might this have looked like?

My answers: yes we could, but requires private-public partnership, not cheap and many practical questions remain.

- Is there political will?

# Insurance and the current pandemic

- ABI on Covid-19
    1. Members to pay out £1.2bn in claims, of which £900mn are business interruption insurance.
    2. Disease coverage usually is limited to a list of specific diseases.
- Lloyd’s
    1. Biggest insurance event ever, dwarfing Katrina ($50bn)
    2. A number of legal claims in US against Lloyd’s synidcates
    3. £15mn for exploring improved insurance of pandemic risks
- Some firms facing particular problems, e.g. Hiscox, a particular problem in their policy wording

  “ the policy requires notification to a public authority upon awareness of a outbreak at the premises or within a 1 mile radius, and that the authority order closure of the business. ” leading to an action group pressing for payouts

# Public Private Partnership

- From an article by Huw Evans director general of ABI about future pandemic risks.

*“Partnerships between governments and insurance markets to help solve big problems are nothing new; so-called ‘protection gap entity’ schemes exist around the world, most commonly for flooding, terrorism and earthquakes. Here in the UK, we have Flood Re, which I helped set up, as well as Pool Re while other examples include the California Earthquake Authority, the CRC in France and the Earthquake Commission in New Zealand…. to enable insurance protection for risks that would otherwise be uninsurable.”*

# Related thinking: “Disaster Risk Finance”

- Past decade work on sharing financial risk of natural hazards
  - Coordinated by the World Bank https://www.financialprotectionforum.org/
- Protection against financial impact for
  - vulnerable households from flooding/drought
  - businesses from major hazards e.g. Chile earthquake of 2010
  - government assets from all natural hazards
  - national finances
- Implementation: World Bank supported sovereign Cat bonds
  - eg $320mn 2017 pandemic bond for 77 IDA countries; $1.36bn earthquake bond for Chile/ Mexico/ Columbia Peru; described here
- Applicable to future pandemics?

# Issues (1)

- State backed business interruption insurance
- General outline is clear
  - “disaster risk finance” i.e. setting rules in advance for allocating financial costs
  - Premiums to encourage mitigation and forward planning
- Limited diversification of risk, so burden falls on state balance sheet
  - A global risk, unlike tropical storms
    - Where there is diversification e.g Florida and Japan, Caribbean and Phillipines
    - Conventional reinsurance has only a limited role
  - Risk transfer via a combination of pandemic bonds and state backed insurance pools
  - One question: what triggers payout? Declaration of pandemic? By who? National or global?
- Insurers still play a role
  - Collecting premiums, adjusted for coverage and mitigation
  - Claims processing and loss adjustment
  - Balance sheet absorption up to a level that they can “afford”

# Issues (2)

- Not possible to compute risks, actuarially or using models
- Coverage, payout, premiums: some suggestions

  Cover $x$ months of lost revenue, from start of pandemic

  Revenue loss measured against same month 12 months earlier

  Payout when revenue loss exceeds 10% (?)

  Payout a proportion of additional revenue loss (e.g. see example)
- Recommended proportion of revenue, varying sector by sector

  Enough to cover essential overheads – rent, debt service, not total wage bill
- Premiums should be set to control state exposure
  - In effect become a return on being liquid/ unleveraged

Some of these ideas in Milne, Alistair K. L., *A Critical COVID-19 Economic Policy Tool: Retrospective Insurance* (March 21, 2020). Available at SSRN: https://ssrn.com/abstract=3558667

# Example (fabricated)

- Owner managed hotel in Scotland , 50 rooms, 30 staff
- Accounting data from most recent financial year.
  - Revenues: £2.4mn (£0mn)
  - Wage and Salary Costs: £1.6mn (£0.2mn)
  - Mortgage servicing costs: £0.3mn (£0.3mn)
  - Leasing/ depreciation of equipment: £0.2mn (£0.2mn)
  - Building and equipment maintenance: £0.1mn (£0.1mn)
  - Pre-tax earnings, after interest and depreciation £0.2mn (loss of [£0.8mn])
- Recommended coverage one-third of lost revenue (over excess)
  - Premium depending on how much coverage is actually chosen, might choose one-sixth of lost revenue to reduce premium, self insuring with cash reserves
  - Leverage is quite high in this example

# Issues (3)

What level of premium might emerge?

- Total support of this kind for the current pandemic (limited to SMEs) would have been perhaps 3% of GDP for 6 months of coverage

  Calculation of mine in NIESR policy paper 15

- If government is looking for a "payback" period of 20 years. Then premium can be 5% of anticipated pandemic payout. In my Scottish hotel example £80,000 per annum or 3% of revenues or 40% of net pre-tax revenue.
- My 3% of GDP is an average of 8.7% of revenues of the affected businesses. So average premium (assuming this is fully insured) is

  $5\% \times 8.7\% = 0.44\%$ of revenues.

- Will create substantial incentives for self-insurance (deleveraging)

# Issues (4)

Social security/ furlough schemes

- Separate complementary state insurance for individuals
- So pandemic insurance only designed to cover essential staff needed to maintain the business
- Furlough should taper over time to match the income and housing costs covered by social security
- Reemployment of laid off former employees in pandemic should not require advertising/ interview

Better data is key …

# Conclusion

- Some challenging issues
- I am making and effort to sketch out what state supported pandemic insurance will look like
- Focus on *broad outline and political buy-in*
- My calculations suggest that something is possible but requiring relatively high premiums. State support is not cheap.

Many technical details will need to be filled in later

# Questions, Comments & Answer(s)?

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# Thank You

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## Forthcoming Webinars

27 May 2020 (14:30) Leadership In Financial & Technical Firms In A Time Of Covid-19

28 May 2020 (12:00) Contact Tracing – A Solution? A Privacy & GDPR Nightmare? A Technical Bridge Too Far?

29 May 2020 (10:30) Mental Health Assessment And Diagnosis In The Time Of COVID-19

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