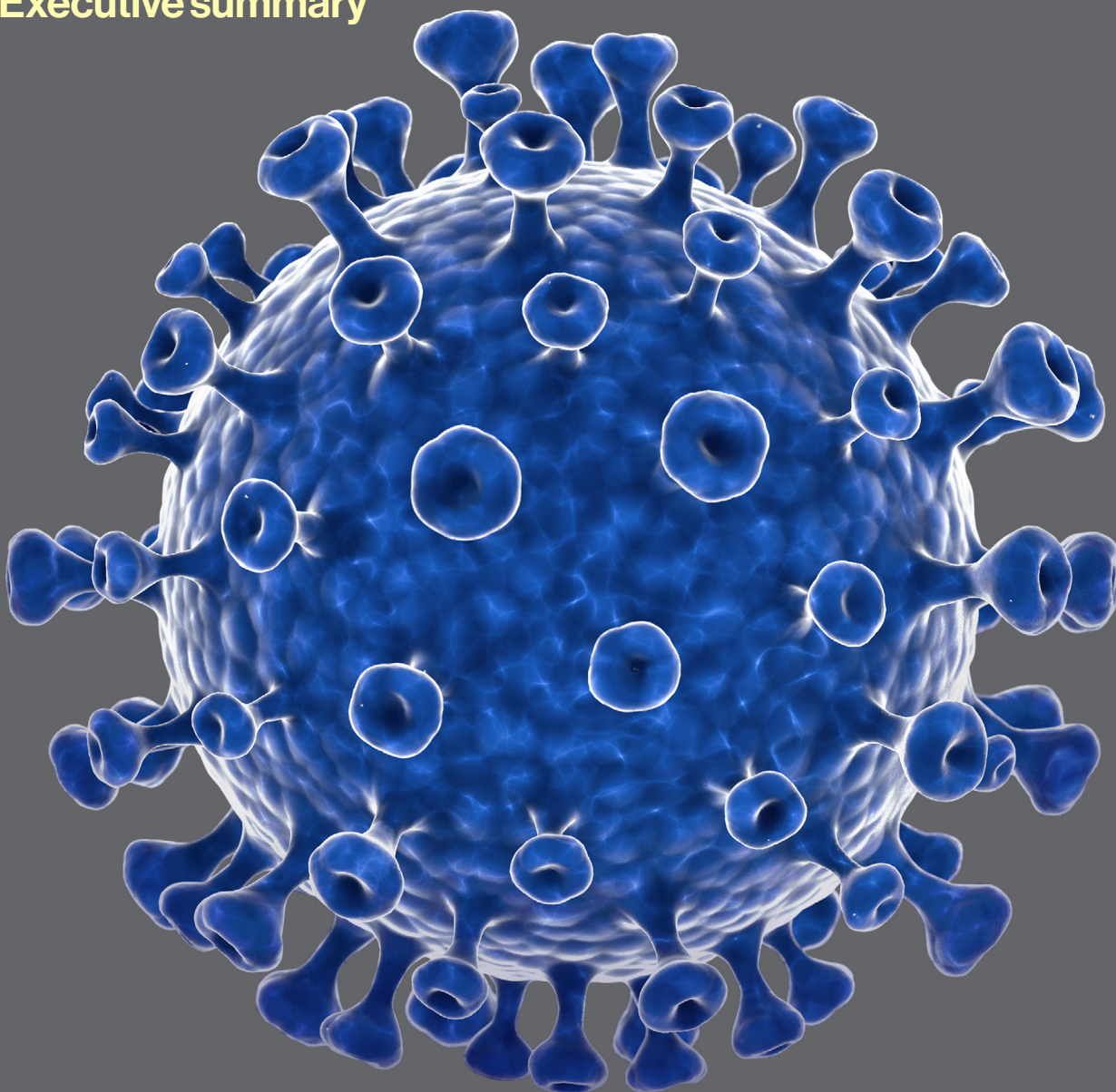


Supporting global recovery and resilience for customers and economies

The insurance industry response to COVID-19

Executive summary





The global impacts of COVID-19

COVID-19 has resulted in a humanitarian crisis on a scale the world was underprepared for.

The magnitude of the pandemic's financial and social impacts has exposed the shortcomings of society's preparedness for, and resilience to, systemic risks of this scale and nature, including the ability of some risk transfer products and structures to provide protection.

Systemic risks such as pandemics that cause large economic and societal losses are unlikely to be covered in their entirety by the global insurance industry as the total economic loss would exceed its financial resources. Where cover is available, premiums can be significant for what many customers have previously regarded as remote threats.

This means the insurance industry must develop new products and structures in those areas where protection gaps exist today to support business recovery over the short-term post lockdown, and provide greater resilience over the medium to longer term.

Lloyd's interviewed executives and experts across key global industries to identify exactly what customers' priorities are. The results were as follows:

In the short-term:

- Ensure business resilience to a second wave of the pandemic
- Safeguard employees as they return to work
- Provide a safe environment for customers as businesses reopen
- Provide clarity of insurance cover

In the medium term:

- More flexible insurance cover for a more volatile business environment
- Ways to increase the resilience of their global supply chains
- In-depth assessment and protection from cyber risk exposures
- Protection from digital economy liabilities

Over the long term:

- Risk prevention and mitigation support
- Advice on preparing for the next systemic risk

Insurers and brokers should therefore focus their development work in these areas to protect customers as they restart their businesses and start operating again, and to strengthen society's resilience more broadly.

Much of this work can be carried out by the global insurance industry itself, working collaboratively to design and develop new products, services and structures. However, to overcome the challenges of offering protection for systemic risks at scale, it must also work with governments to combine (re)insurance capital with capital markets resource and sovereign funds to provide the necessary security and capacity to pay claims.

This Lloyd's paper sets out ways the industry can do this. It aims to stimulate innovation and accelerate development by proposing new solutions that could be developed and adopted by the global insurance industry to protect businesses and society in the short to medium term. It also sets out proposals for region-specific vehicles that could offer protection against systemic risks over the longer term.

A pathway to recovery

Covering customers' risks in the short term

As governments begin to ease restrictions on businesses and individuals, companies are taking tentative steps to begin operating again.

The return to work is fraught with complexity. Companies need to keep their employees and customers safe, both from the current virus and from any potential further waves. At the same time, they are facing restricted working conditions, falling demand and changing customer behaviours. This is changing the type of risk protection they are looking for over the short, medium and long-term.

For some of these short-term risks, most businesses should be able to obtain the core commercial insurances that protect their employees and customers (e.g. public liability, employers' liability/workers' compensation, professional indemnity) as they restart operations, provided they can demonstrate that they are following government guidelines on social distancing and PPE usage.

For other risks this will be more challenging. Most businesses operated without cover for non-damage business interruption for communicable disease prior to COVID-19, but the demand for cover that includes protection against a second wave of the pandemic will now be significant. In some countries, the threat of a second wave could make new COVID-19 business interruption cover unaffordable for customers (many of whom are already struggling from the effects of the current lockdown), or loss-making for insurers (many of whom are already heavily exposed to COVID-19 losses). These will require new solutions because cover does not currently exist. Lloyd's has come up with one potential solution, *ReStart* (see box).

ReStart is a potential new insurance solution the Lloyd's market is currently developing that could help. It would offer business coverage for future waves of COVID-19 by pooling capacity from several Lloyd's market participants. It would initially be aimed at smaller businesses, potentially expanding across a broader range of SMEs and mid-market over time. It will still be subject to the usual Lloyd's performance management requirements and competition law considerations.

Benefits could include:

- Resilience for a key sector of the economy and support for the recovery from COVID-19
- Certainty of business interruption coverage for a second wave of COVID-19 to customers where few alternatives are available
- Contributes directly to customers and their recovery from COVID-19, helping strengthen customer relationships over time
- Potential application outside the Lloyd's market e.g. through involvement of wider London market and global reinsurers
- Manages affordability and insurers' exposure through risk pooling, variable limits and industry or geographical diversification
- *ReStart* could also provide a complementary offering to *Recover Re* (see below)

A pathway to recovery

Covering customers' risks in the short term

Accelerating the reopening of society by insuring the COVID-19 exit strategy

There is broad consensus that life can only return to normality after a vaccine is developed, distributed and administered around the world. The insurance industry has a major role to play in insuring the many risks associated with this medical response. For example, there are already multiple trials underway to test existing medicines' impact on COVID-19 in terms of treatment and prevention, all of which require insurance, and some of which are being insured through the Lloyd's market.

As a new vaccine is developed further, larger scale medical trials will be required, and ultimately once approved and manufactured at scale, it will need to be transported safely around the world. This will carry significant risk and will also require insurance. Insurers need to be prepared to write these risks at short notice at a significant scale.

Building greater resilience

Covering customers' risks over the medium term

From traditional physical damage business interruption policies through to motor vehicle, public liability, employers' liability and directors' and officers' insurance, customers are re-evaluating their risks in light of changing business practices, and the effectiveness of the protection offered by their insurers.

The global insurance industry must respond urgently to customers' changing needs. If it doesn't it risks losing customers who could seek to establish or increase their use of self-insurance through captives, or not buy cover at all.

Flexible coverage for a more volatile business environment

With levels of output varying significantly as firms ramp production up or down in response to government restrictions and with others adopting more flexible business models, customers are seeking more flexible coverage with dynamic risk-pricing that reflects their real-time risk profile.

Although some insurance policies often include a component based on use – in aviation and employer liability/workers' compensation, for example – customers could seek coverage that adapts to varying exposures, possibly in near real-time, in more areas in the future. This could be offered through increased use of internet of things data (e.g. from sensors, telematics, mobile phones etc.), the provision of more on-demand policies, or simply by adding variable components to existing cover.

Increasing global supply chain resilience

The COVID-19 pandemic has exposed the vulnerability of the global supply chain, with many industries, including automotive, manufacturing, consumer electronics and food, significantly impacted by the near total shutdown of goods transportation.

Supply chain cover does exist today but can be complex to underwrite and costly to insure. Insurers need to develop a wider range of solutions that can fulfil this growing need, but to do this they will need the data to understand the networks that exist and the risks to which they are exposed.

Protection for new cyber risk exposures

Whilst some industries will return to onsite working as before, many employers and employees will incorporate new ways of working in the future (e.g. more people remote working or transacting more business online). This will increase their risk exposure, particularly cyber risk, making cyber security and data protection even more important for businesses.

Customers, therefore, will need new solutions from brokers and insurers to assess, mitigate and transfer their growing cyber risk effectively. To cater for this need, the insurance industry will have to build on its already strong cyber offering by creating new solutions suitable for a greater and more dispersed cyber threat.

Building greater resilience

Covering customers' risks over the medium term

Protection for new digital economy liabilities

Businesses are increasingly adapting to and taking advantage of digitised business models and automation. This rapid transition to digital working is potentially changing the risk profiles of businesses across the value chain.

Customers need insurance solutions that offer protection against the intangible risks and liabilities that derive from doing business digitally, and that more accurately reflect their assets and operations. While liability protection is well established, its development and customer support must match the increasing pace of evolving liability risks.

Creating new solutions for new risks

To support customers' fast-evolving needs in light of these new risks and changing business models, and to continue to offer a compelling value proposition, insurers and brokers must work together to put more time, effort and resources into developing relevant products and services, as well as the data and technology infrastructure to support them. For example, it is anticipated that brokers and insurers will need to collaborate to clarify protection for non-damage business interruption, either within property policies or as a standalone cover.

For its part, Lloyd's is encouraging innovation by permitting syndicates to write an additional 2% of premiums on new product innovation on top of their business as usual plan. The Lloyd's market is also working with its Product Innovation Facility to accelerate product development and design in response to customers' changing risk profiles.

Protection against systemic risks: developing industry-wide underwriting expertise

The insurance sector and its customers would benefit from new centres of excellence to develop and share greater understanding of pandemics and other systemic risks. These would support the development of new insurance products, services and risk management solutions

Such centres of excellence could include support for new product innovation, new technical capabilities and services to support insurers, and academic partnerships to develop a better understanding of systemic risks and customers' emerging needs. Lloyd's will start developing these capabilities, and to kickstart this process, Lloyd's is including insurtechs that can provide some of these capabilities in the next cohort of its innovation lab.

Funding new pandemic risk products

While the insurance industry has the expertise to match pandemic risk to capital, it does not have the capacity to do this at scale due to the systemic nature of the risk.

The global, commercial (re)insurance industry's total capital base sits at around \$2 trillion compared to an estimated \$180 trillion managed by the capital markets. The global (re)insurance industry has an opportunity to work with the capital markets to access their capacity to offer parametric protection for pandemics and non-damage business interruption through structures such as pandemic catastrophe bonds. Initial research suggests capital market participants may have the appetite to underwrite products that offer protection against future pandemics; at the same time customer demand has increased significantly.

The Future at Lloyd's capital workstream is already working on ways to attract the type of institutional investors that would be interested in supporting pandemic risk, including potentially establishing an efficient Insurance Linked Securities (ILS) structure.

However, while the capital markets provide an opportunity for expansion of commercial capital to support these risks, government partnerships are required for cover at a national level.

Protecting the future

Frameworks for government and insurance industry partnerships to protect society over the longer term

As society recovers from the impacts of COVID-19, it must do so in a way that makes it more resilient to the next systemic risk.

Systemic risks are challenging to predict and model, and are so large in scale they render traditional risk mitigation and transfer methods unfeasible, requiring financial resources far in excess of the global nonlife (re)insurance industry's \$2 trillion asset pool.

As the pandemic has shown, when a systemic event occurs, given the limited commercial cover, governments step in to protect their citizens. This has been effective – whether through business loans, assorted backstops or economic stimuli – and these remain a viable means of continuing to protect society from systemic risks.

However, this approach does not change society's understanding of systemic risks or incentivise behavioural changes that help mitigate their impact, and means taxpayers and future generations end up paying the cost.

Although the global insurance industry does not have the capacity to absorb systemic catastrophic events ('black swan' events) on its own, it can help develop national or regional structures that could provide protection.

Two potential frameworks for insuring systemic risks

Lloyd's is proposing two national or regional frameworks that, if taken forward, could provide governments around the world with risk transfer models they could put in place immediately in partnership with the insurance industry.

Lloyd's has published these 'open source' frameworks to provide a blueprint for government and insurance industry partnerships that strengthen societal resilience in the face of black swan events.

The first government and industry open-source framework, *Recover Re*, is an 'after the event' insurance product framework, which could provide immediate relief and cover for non-damage business interruption, including the current COVID-19 pandemic, and over the long-term.

If implemented, this could be an efficient way to inject commercial and government funds into the economy, providing relief to customers with limited borrowing capacity. This framework could be implemented in any country where government has the resources and industry commitment to support it.

Customer benefits could include:

- Immediate cash injection and recovery support, paid for over the long term
- Non-damage business interruption coverage for future waves of the COVID-19 pandemic should disruption continue past a specified time period or losses exceed a specified excess
- Non-damage business interruption cover for future pandemics and possibly for other systemic events

Protecting the future

Frameworks for government and insurance industry partnerships to protect society over the longer term

The second framework, *Black Swan Re*, is a reinsurance framework for government and insurance industry partnership which could enable insurers to provide non-damage business interruption cover that offers customers more protection from the devastating and long-term impacts of systemic catastrophic events.

If implemented, this structure would enable industry pooled capital to provide reinsurance for the impacts of future black swan events, backed by a government guarantee should the pooled assets become exhausted. The design of this structure includes the requirement for an initial commercial and industry pooled layer of funds, enabling faster pay-outs to customers, as well as a buffer for governments before they need to step in.

Customer benefits could include:

- Non-damage business interruption cover for a black swan event, certainty of cover and quick pay-out
- Could cover secondary impacts of future events such as supply chain disruption or ability to access lending to help the cost of relaunching a business following black swan event-related interruption

These two structures could be used in combination: *Recover Re* could offer immediate positive impacts to a targeted portion of SMEs, whilst *Black Swan Re* could offer protection against the next crisis to a wider set of businesses, creating greater resilience to future systemic risks.

Protection offered by Lloyd's proposals

The potential solutions in this paper include *ReStart* (pooled insurance capacity to protect customers against a second wave of COVID-19); *Recover Re* (a government-backed vehicle

offering long term 'after the event' cover that could insure against COVID-19 as well as future pandemic risks); and *Black Swan Re* (a government-backed vehicle to insure against future systemic risks).

	Current COVID-19	Second wave COVID-19	Future pandemic	Future systemic risk
<i>Recover Re</i>	✓	✓	✓	?
<i>ReStart</i>		✓	?	
<i>Black Swan Re</i>			✓	✓

Global collaboration: recommendations for fast-tracking action

The global insurance industry could do the following to protect customers and society more broadly in the short, medium and long term:

- Create new risk transfer mechanisms, such as *ReStart*, that give customers the confidence of protection from a second wave of the pandemic or from future pandemics.
- Accelerate product development, supporting data and underwriting capabilities to align to customers' new needs following the impacts of COVID-19 on business models and operations.
- Provide the expertise required to assess and better manage systemic risks, and work with governments to build risk transfer mechanisms, such as *Black Swan Re* and *Recover Re*, that provide society with greater resilience to systemic risks over the longer term.

Delivering these initiatives at the pace and scale needed to help customers and wider society will require close collaboration between the insurance industry, governments, customers, and, in some cases, the capital markets and non-governmental organisations. They will also take time to develop (i.e. *ReStart* 2-3 months; *Recover Re* 3-6 months; *Black Swan Re* 6-12 months) so will require the industry working independently, and with governments, to get started immediately.

Lloyd's actions

For its part, Lloyd's will provide seed funding of up to £15m to support this process, and use its marketplace to act as a convenor and incubator to develop some of these initiatives. Lloyd's will co-design and pilot initiatives in the London market and across the UK, with the support of its Advisory Committee members.

Actions include:

- Facilitating the launch of new solutions from the Lloyd's market to support business recovery following the current pandemic, including business interruption coverage for future waves of COVID-19 and effective cover for supply chains for vaccine distribution to developing economies
- Working with Lloyd's Product Innovation Facility through a series of 'sprints' to accelerate product development to meet customers' changing needs better following COVID-19
- Piloting initial components of a Centre of Excellence for systemic risk, including working with the Chartered Insurance Institute, the Lloyd's Market Association and other industry bodies to launch a training and education programme to develop the skills and capabilities that will be to protect customers better against systemic risk
- Refining the open source frameworks for *Black Swan Re* and *Recover Re* in collaboration with the insurance industry, and selected governments and regulators around the world
- Working with Lloyd's London and Global Advisory Committees to establish a technical working group to guide the development of these initiatives

Lloyd's request of its stakeholders

- Share your feedback on the ideas in this paper, or suggest new solutions
- Where desirable, provide support for the initiatives and actions proposed in this document
- Work with Lloyd's and the wider insurance industry to develop these ideas further
- Support discussion, development and implementation of these proposals around the world

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