Transformation of Underwriting & Risk Assessment Due to COVID-19

Preparing for the Future

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COVID-19 has had a dramatic impact on the U.S. and worldwide economies – the long-term repercussions of which could take a substantial period of time to truly actualize. Within that dynamic, the insurance marketplace will most certainly experience changes that will materialize as the crisis evolves and reaches a conclusion. Previous major world events have significantly altered the insurance landscape to a substantial level:

- 2001 Terrorist attack on the United States
- 2011 Japanese earthquake and tsunami
- 2017 Hurricanes Harvey, Irma and Maria

Although each of these events were natural disasters and have different loss drivers than COVID-19, none of these events have had the direct impact on the worldwide economy and societal disruption as COVID-19. Based on the broad reaching ramifications of COVID-19 and the repercussions worldwide, we anticipate that the insurance marketplace will re-evaluate certain aspects of underwriting and assessing risk that could impact the process of negotiating, pricing and binding insurance coverage for insureds.

Pre-COVID-19 Marketplace

Prior to the COVID-19 outbreak, the Property & Casualty insurance marketplace was already experiencing volatility with certain lines of coverage – most directly, Commercial Automobile Liability, Commercial Umbrella Liability and Commercial Property coverage. These lines of coverage were facing various challenges, resulting in restriction of terms, rate increases and more focused underwriting guidelines around comprehensive data, financial status, internal protocols and risk management philosophy.

Rate increases in the 5-15% range for Auto Liability and in the 10-20%+ for Umbrella and Property were not unexpected in the existing market climate. Social inflation continued to be an increasing factor within the insurance landscape – with carriers revisiting their rating methodologies based on the impact of claim demand and nuclear jury verdicts. These awards resulted in increased costs of claims settlements, legal fees for defending and appealing verdicts, as well as carrier loss reserving practices.

In addition, recent findings by **Colorado State University's Department of Atmospheric Science** indicate a higher than average 2020 Atlantic basin hurricane season forecast **(i.e. projected 16 named storms vs. analysis average of 12.1 named storms – and a 69% chance of a category 3, 4 or 5 hurricane hitting the continental U.S. coastline vs. the century average of 52%)**.

This combination of factors was already creating an environment for a fluctuating insurance market for 2020. The unexpected, unforeseen and still unknown ramifications of COVID-19 for the economy and the insurance industry will likely play an additional part in challenging negotiations for 2020.

COVID-19 Driven Impacts

The business operational changes that have arisen due to teleworking and stay-at-home orders, as a result of COVID-19, have raised issues with other lines of coverage that could be material in the upcoming months or years. This document will focus on a few coverages that may not be as obvious as the business interruption issue that has led to state attempts to pass retroactive legislation, as well as industry discussions around potential pandemic federal backstop*.

The following are a few key alternative coverage concerns that may be impacted drastically as COVID-19 measures continue to be enforced.

Workers' Compensation

Coverage under Workers' Compensation policies has been determined by certain states as a potential resource for payment of COVID-19 claims for employees. As of April 14, 2020, states, such as Kentucky, were moving forward in extending Workers Compensation benefits to certain workers who had the COVID-19 virus.

Also, reduction/elimination of operations for businesses resulting in lower payrolls may result in carriers receiving more claims, but lower Workers' Compensation premium – causing loss ratio spikes and carrier responses to adjust their rating methodologies to fund for losses that will develop in the future. Regarding the premium impact, **California State Insurance Commissioner Ricardo Lara's order of April 13, 2020** has directed that insurance carriers return portions of policy premiums to insureds due to the exposure impact of COVID-19 for specified lines of coverage. Reasonable expectation is that other states will shortly follow suit regarding this position – resulting in significant adjustment to carrier premiums to support their loss payments.

Although the Workers' Compensation market has been extremely soft for close to a decade, there have been indications that the aggressive Workers' Compensation marketplace would start to level off, or even begin hardening, in the near future. A broad ranging event, such as COVID-19, could potentially be a trigger for carriers to become more conservative in their guaranteed cost underwriting philosophy.

As a result of these issues, carriers may begin to limit the application of scheduled discounts or premium credits that they apply as part of their underwriting rating factors – resulting in increased premiums for programs that are still performing well from a loss perspective. They may also determine certain classes of business may be more likely to create loss scenarios and adjust premiums for those operations to reduce their potential for loss.

Cyber Liability

Companies of all sizes have experienced the need to shift from an office work environment to telework as the core platform for their employees due to the COVID-19 crisis. In many cases, organizations were prepared for a small percentage of work-from-home operations or colleagues on business travel. However, altering their IT platforms to support the entire organization may not have been a situation they were prepared to handle. As transition to this platform was in progress, the opportunity for hackers and system intruders increased and created the potential for greater cyber events or incidents.

Incidents, such as "Zoom bombing" – where third parties infiltrate business online conference calls – have become routine during the COVID-19 crisis with such a large increase in online meetings as an alternative to in-person meetings. Although often seen as a nuisance and disruption to business activities, these incidents have the potential for intruders to obtain confidential or sensitive information that could create greater problems for an organization.

As the volume of claims increases within the insurance marketplace, carriers will place greater scrutiny on the internal protocols and procedures of their insureds to protect against these types of events. The increased volume of claims and incidents received by the carriers may result in:

- Less available capacity and access to limits
- Coverage restrictions, if certain protocols and procedures are not in place
- Increases in retentions or lower sublimits for certain events
- Possible declinations due to changed carrier risk appetite

Whereas in the past there has been substantial capacity in the marketplace for Cyber insurance, an event such as COVID-19 could result in an alteration to carrier underwriting processes that insureds would be wise to evaluate well ahead of their scheduled renewal.

Employment Practices Liability

One of the most unfortunate business-related aspects of COVID-19 is the necessity for many organizations to either furlough or lay off a portion or majority of their employee base. Mass reduction-in-force situations of this nature often lead to an increase in the number of wrongful termination claims by employees who feel they were treated unjustly as part of the process. In addition, the impact that the industry will realize due to volume of claims may result in an overall market shift in pricing for these Employment Practices Liability Insurance (EPLI) policies.

With this crisis creating the potential for an increase in EPLI claims on a grand scale, carriers will be revisiting the guidelines and methodologies organizations use to reduce their staff, as well as the likelihood that an organization would experience the need to lessen their workforce. Utilizing resources, such as the Center for Disease Control and Prevention (CDC) website*, regarding measures to address the impact of business operations from COVID-19 will be helpful in providing carriers with assurances regarding an organization's focus on loss mitigation. Continued improvements and enhancements to best practices regarding employees will improve an organization's risk profile, in the carrier's opinion, and create the opportunity to negotiate broader program terms and more aggressive pricing.

Recent past events, such as Wage & Hour claims and the #MeToo movement, have directly impacted underwriting philosophy, coverage terms and retention in the EPLI marketplace. The expectation that COVID-19 will have a similar impact is not outside the realm of possibility.

Renewal Process

To mitigate the potential negative impact of COVID-19 on expected renewal premiums, a comprehensive evaluation of risk exposures for the upcoming policy term is warranted. Understanding your exposure changes and aggressive communications with your broker and carrier, as early as feasible, will provide you with greater latitude in determining the best options relative to your Total Cost of Risk. Early discussions with your broker - we would suggest 120 days prior to renewal - regarding program structures, coverage terms, limits and carrier expectations would be beneficial.

Although this paper has focused primarily on Workers' Compensation, Cyber Liability and Employment Practices Liability, the program analysis should be a comprehensive review of all coverages – including, but not limited to, Commercial Property, General Liability, Umbrella Liability, Directors & Officers Liability and all other insurance coverages you currently purchase or should evaluate. Examples of several key enhancements or sublimits you should be evaluating and discussing as part of your renewal that are applicable to COVID-19 related events are:

- Contingent Business Interruption and Communicable Disease coverage under your Commercial Property policy
- An endorsement for Communicable Disease coverage under your Event Cancellation policy
- Crisis Management response sublimit protection under Commercial Property and Umbrella Liability policies
- Understanding the Vacancy provision under your Property policy and the policy trigger
- Communicable Disease or Pollution exclusions under General Liability policies (and how the term "pollution" is defined under the policy)

The review of your program should also include assessment of potential alternative risk solutions, such as loss sensitive or captive utilization. Although these options may create other challenges – e.g. need for collateral, which may be less appealing for insureds in the current economic environment – a full evaluation of all program options could also provide insureds and brokers with leverage to negotiate renewal terms with carriers.

Understanding program payment terms prior to binding and the ability to make program adjustments, midterm and in the future, should be part of any discussion with your carrier partner, as well. Having the flexibility to adjust your exposures and/or premium payments in the event of a similar future event to COVID-19 can be critical relative to your cash flow and prioritization of internal expense needs.

Summary

1. Review your program thoroughly with your broker and determine any coverage enhancements that are critical as part of your renewal negotiations with the markets.

2. Conduct early discussion around exposure and operating changes with your broker/agent to assess strategy around renewal negotiations.

3. Obtain carrier positions regarding revisions to their rating methodology relative to any COVID-19 impacts on their operations – including internal directives associated with coverage restrictions, enhancements, pricing, renewals and declinations.

4. Evaluate alternative program structures, limit needs, deductibles/retentions to lessen financial impact to your Total Cost of Risk.

5. Determine flexibility of premium payment options, including premium financing, to spread the costs and provide options for adjustments, as warranted.

In closing, the ultimate ramifications and impact of COVID-19 upon the insurance industry are certainly still to be determined from both an immediate and long-term perspective. However, proactive evaluation of your operating risks, program structures, market partners and early engagement with your broker/agent in your renewal process will provide a better understanding regarding your renewal expectations and allow more time to sufficiently mitigate the still evolving impacts of COVID-19.

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The COVID-19 situation is changing hour by hour and we recognize these observations are very fluid. The intent of this document is to provide insight into claims considerations and how the current COVID-19 case could impact them.