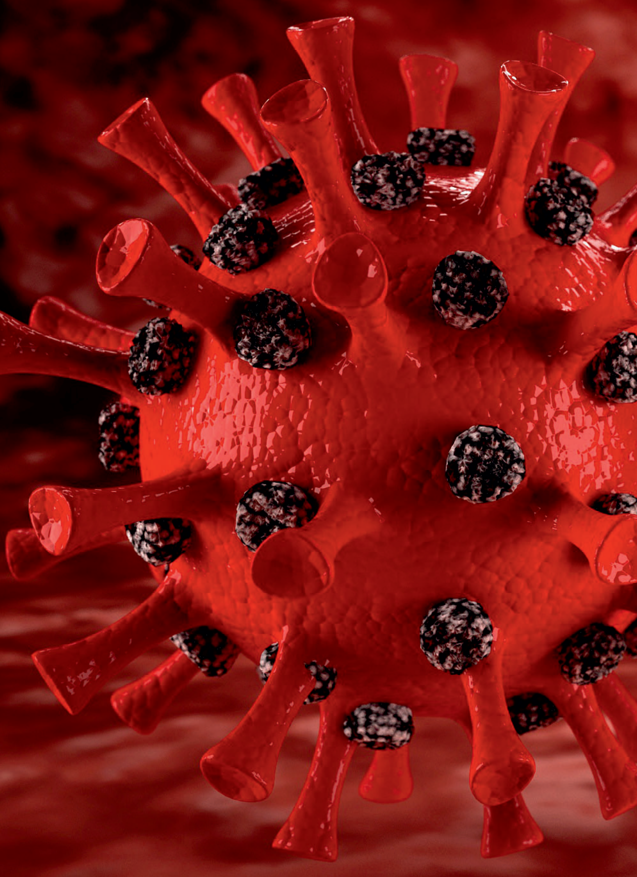


IMPACT OF PANDEMIC COVID -19 ON THE INDIAN INSURANCE INDUSTRY

A Report by

National Insurance Academy, Pune

NATIONAL INSURANCE ACADEMY

INTRODUCTION:

Covid-19 pandemic is posing challenges of unimaginable proportion to mankind. The virus is highly contagious and has caused already large number of fatalities around the world. The number of people infected with this virus globally has already crossed 2.8 million leaving more than 1,90,000 people dead. The greatest impact has so far been on developed European countries and USA. The development of vaccine is likely to take months and there is no clear cure for the disease. It is expected that the virus will spread all over the world and reach large section of the human race. The countries have attempted to reduce the effect of the virus or flatten the curve by resorting to total or partial lockdown with a serious impact on the way people live and causing economic misery. Social distancing and lockdown have changed the way business is being done.

The economic impact of Covid-19 on the world economy is expected to be huge. IMF has predicted a severe recession in 2020. IMF has said that corona virus pandemic hit the world economy when it was already in a fragile state as it was weighed down by trade disputes, policy uncertainty and geopolitical tensions. IMF further added that the pandemic poses daunting challenges for policy makers in many emerging markets and developing economies, especially where there are weak public health systems, capacity constraints and limited policy space to mitigate the outbreak's repercussions.

Indian government has been highly proactive in dealing with the situation. A nationwide lockdown was imposed effective March 25, 2020 for 21 days in phase one and this was extended by another 19 days in the second phase. A limited opening is being done in non-hotspot areas to kick start the economy in a limited way.

These severe measures have led to the complete closure of the movement of people outside their homes and all economic activities except for very essential items, forcing people to 'work from home'. The closure of all economic activities along with suspension of all the public and private transport including the Indian Railways and Airways has led to stalling of the growth of the economy.

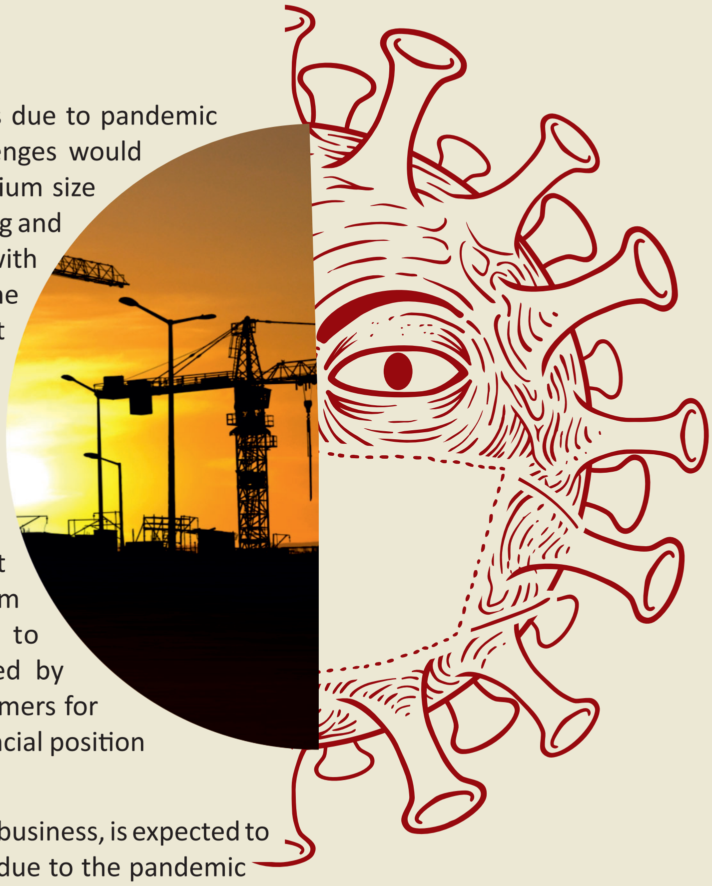
The lockdown has created huge impact on the economy especially for the workers of the informal sector and rural areas. The government and RBI have come out with policy initiatives to give relief to various sections of the society. The GDP for FY 2020 which was already low is expected to come down further. The adverse effect of pandemic will be felt in the current fiscal with IMF expecting GDP to be around 1.9%. There is however an expectation of a sharp recovery in the Financial Year 2021-22.

IRDAI has permitted continuance of cover in the event of delayed renewal of policies in health and motor TP covers. In life space longer grace period has been given for payment of premium. IRDAI has provided insurers with additional timelines for various compliance requirements due to lockdown situation. Indian insurance sector would clearly experience the adverse effect of the pandemic in various ways. The economic downturn and the effect on the economic well being of people would definitely impact the industry. The lockdown and social distancing is changing in a big way the business is to be done. The insurance business is largely done using personal contacts and the pandemic is changing the way business is being done in the insurance sector. Digital would get a huge push and this would be a big gain for the industry which was slow to leverage technology in its operations.

Eminent economists like Keynes, Knight and Hayek have studied the difference between risk and uncertainty. Insurers as the risk carriers have been well equipped to handle the risks, especially pure risk and are experts in estimating the probability of an event that could cause economic loss. However, uncertainty is something unknown and thus unmeasurable. As Keynes famously put it *"About these matters there is no scientific basis on which to form any calculable profitability what so ever. We simply do not know"*

IMPACT ON THE NON-LIFE INSURANCE INDUSTRY:

BUSINESS:



The General Insurance sector will see a drop in business due to pandemic situation till normalcy is achieved. The economic challenges would impact many big corporates and most of Small and medium size corporates would find it difficult to pay premium for existing and new covers. No new capacity is expected to be added with negative consequences on the Engineering portfolio. Marine cargo insurance would see drop due to reduced transport movements and economic activity. Covers like Event cancellation would be affected for some time till lockdown scenario continues. MSME sector is likely to be seriously impacted and this could potentially reduce their premium paying ability.

However the advantage for the insurers is the recent premium hike in Fire portfolio, due to pressure from reinsurers. Likely fallout in corporate business due to economic slowdown would be more than compensated by premium hike. There is likely to be a demand from customers for reduced premium rates in Fire insurance due to their financial position and also due to low or no activity in their risks.

Retail business, which largely consists of Motor and Health business, is expected to behave differently. Automobile sales will continue to fall due to the pandemic situation, further to the poor performance in the automobile sector in the previous year. Motor premium will therefore be adversely impacted. There will also be pressure from customers for premium refunds as vehicles have been laid up, for long time due to lockdown. Health business will see an increase in demand due to Covid-19 situation. The high cost of treatment of Covid-19 in private hospitals and general fear of diseases will give a big Fillip to demand for health insurance.

The industry will see new retail Covid products providing lump sum benefit payments, Covid health covers and unemployment covers. However the biggest demand is likely to emerge in respect of loss due to business interruption arising out of pandemic. There will be demand for pandemic extension in liability, event cancellation and such other covers.

CLAIMS OUTGO :

Health Insurance Claims Outgo due to Covid-19 will increase significantly over time with more infections happening in the current year. Health insurance coverage which has already been expanded due to Regulatory initiative will see further strain due to Covid-19. The cost of Covid treatment in private hospitals is very high. As more and more Covid affected customers start using private hospitals, the claims experience of health insurers could increase. It is necessary for insurers to collaborate with hospitals to bring down the cost of hospitalization. The possibility of adverse selection also exists for insurers in this scenario.

Claims in other major lines like motor and property should show significant improvement due to total and partial lockdown. However, workmen compensation, credit insurance portfolios would see higher claims outgo. The other smaller portfolios should not see any major deviation in their performance.

The biggest challenge is potential claims due to Business interruption preferred by customers though they are not payable as per policy terms. It is also possible some all risks wordings are open to give rise to expectations. There is a clear possibility for some of these claims to land in long drawn litigation.

INVESTMENT:

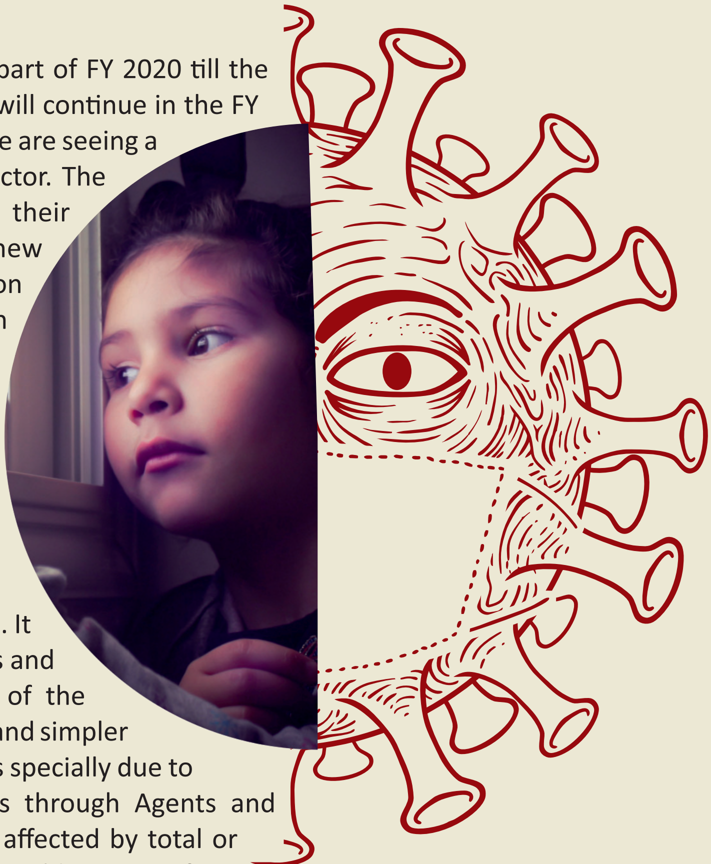
The biggest impact for insurers would come from the investment earnings side. The equities have shown huge decline as much as 25% from their peak values. This could impact earnings of insurers dependent on sale of equities. The fair value of equities will come down. There may even be a need to absorb losses on equities for insurers. The interest rates are expected to drop and this will impact the investment income from debt instruments. The economic slowdown will have its consequences on the investments in corporate bonds which could come under stress due to business challenges. The net effect of all of these is clear stress on the investments and earnings of insurers. The impact on individual insurers will vary based on investment profile of the insurers.

PROFITABILITY AND SOLVENCY:

The profitability of General insurers would consequently be under pressure. However it must be added that insurance sector would fare comparatively better in the financial services space. Companies whose solvency is borderline would be under pressure to bring in more capital. It is also time for Regulators to make companies build for cushions for pandemic situations in the interest of policyholders. Insurers should build catastrophe reserves in their balance sheets to be used in extreme situations to honour their commitments to Policyholders. The Government and Regulator should incentivize this by allowing Tax breaks.

IMPACT ON THE LIFE INSURANCE INDUSTRY:

BUSINESS:



Life insurance industry had a very good growth in most part of FY 2020 till the pandemic struck in March 2020. The impact of Covid-19 will continue in the FY 2021 in a significant way. The disposable incomes of people are seeing a big erosion and thus will impact new business of the sector. The economic fallout of Covid-19 will make people delay their decisions to take life insurance. It is expected that new businesses will remain flat. The adverse effect will also be on renewal premium despite the extended grace period given by the industry to pay the premium. The impact on the industry will depend upon how long the lockdown continues and the economy is able to come back to normalcy. Clearly first quarter will see bigger impact and things should gradually improve as the year progresses. There could be potentially more surrenders as people would like to improve their liquidity situation.

The persistency ratios of the companies will also take a hit. It is necessary for insurers to devise various mitigation steps and customer contact programmes to minimise the effect of the pandemic. The insurers need to come out with innovative and simpler products which can be taken by customers with no hassles specially due to restrictions on mobility. Large part of life insurance is through Agents and Bancassurance channels. Both these channels would be affected by total or partial lockdown and also social distancing norms which would continue for a longer period. The insurers need to come out with innovative digital solutions to overcome the handicap of the traditional selling approach.

CLAIMS OUTGO:

Mortality rates are around 5% to 8% due to Covid-19 across the globe. India is experiencing a mortality rate of around 3.5% at this point of time. As number of people infected is likely to increase significantly the number of deaths due to the pandemic will be high during the year. This will clearly have an impact on the claims outgo of insurers. While it is difficult to factor pandemic in the premium calculations, the Actuaries need to build models to assess the effect of similar pandemic on mortality tables and as a result on the premium.

LOANS / SURRENDERS:

The companies can expect increase in the applications for loans and surrenders on the existing policies due to the need for immediate liquidity on account of layoffs of the income earners. The companies would also need to take concerted efforts to prevent the surrenders in case the values are less than the expectation of the policyholders. Any delays in processing these requests may lead to distrust of the companies. The Companies need to convince the policyholders to avail loan rather than surrender the policy as surrender would result in loss of valuable life cover.

INVESTMENTS:

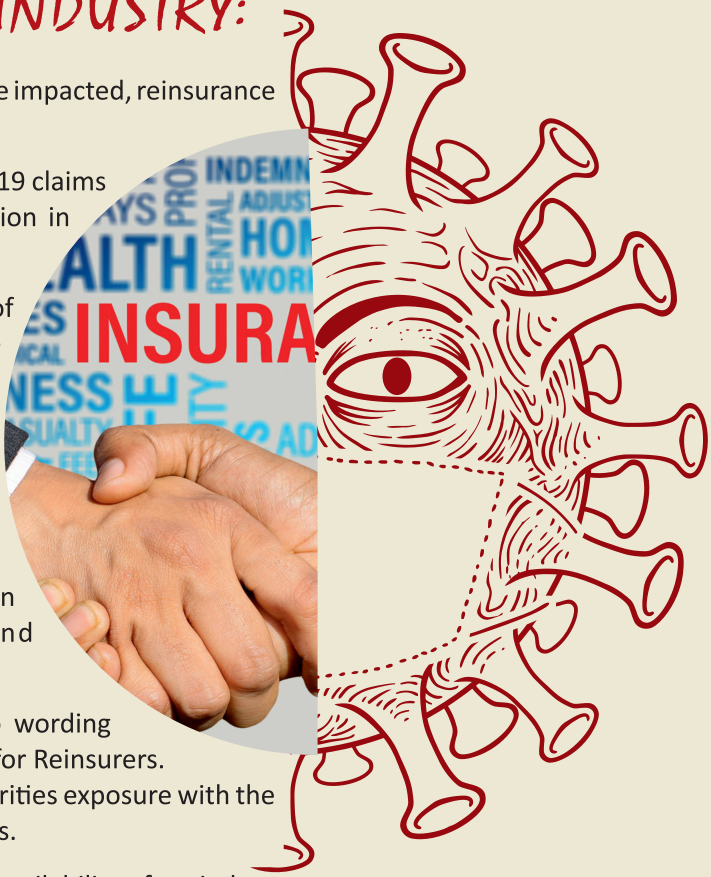
The huge drop in Sensex and Nifty will have a negative consequence on the investment earning and also the investment book of life insurers. The low interest rate scenario will also impact the investment income. The quality of investments in corporate bonds would come under pressure. ULIP portfolio will also come under pressure due to the same reasons

.PROFITABILITY AND SOLVENCY:

While profits would be under pressure due to premium income remaining flat and investment returns taking a hit, the industry should perform well as compared to other sectors of the economy. Mark to market losses could affect the solvency of some insurers requiring fresh infusion of capital.

The Bonus declarations to policyholders would also be consequently impacted.

IMPACT ON REINSURANCE INDUSTRY:

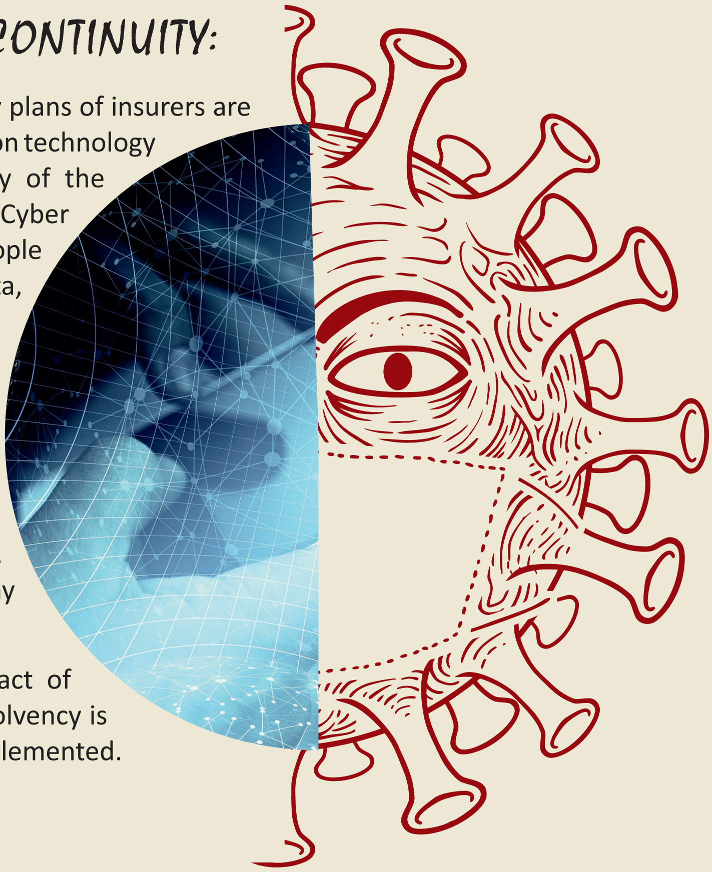


- As volumes in primary insurance lines are going to be impacted, reinsurance business will remain flat.
- The Dowling and Partners analysts estimate Covid-19 claims in the range of $40 Billion to as high as $80 Billion in Property and Casualty lines.
- Reinsurers with exposure to health and life lines of business may see higher claims outgo due to huge number of infections and mortality around the globe.
- Reinsurers with higher exposure to event cancellation covers , Business interruption covers due to pandemic may face big claims.
- Investment returns will be impacted due to erosion in equity values, drop in interest rates and deterioration in quality of investments.
- The possibility of silent pandemic covers due to wording issues is there. The losses are likely to be long tail for Reinsurers. This could have an impact on Insurance-linked securities exposure with the possibility of collateral to be trapped for long periods.
- As global economy is likely to be affected severely availability of capital could come under pressure. This could lead to moderate hardening of rates.
- There could be increased activity in Mergers and takeovers.

GENERAL:

RISK MANAGEMENT AND BUSINESS CONTINUITY:

The Risk Management practices and Business Continuity plans of insurers are severely tested due to pandemic. The large dependence on technology specially outsourced would increase the vulnerability of the industry to scaling up and also increased cyber Risks. Cyber Risks have increased manifold with large number of people working from home with access to central servers, Data, etc.



The activities which have always been done through physical contacts like marketing, Risk inspection, loss assessments, legacy business practices all need to be changed in the new situation quickly. The quick change from physical to pure digital can expose many of the controls in the organization vulnerable to malpractices. The controls have to be quickly redesigned to prevent any negative consequences.

Companies need to build scenarios wherein the impact of pandemic on the important business parameters and solvency is evaluated and necessary mitigation is strategized and implemented.

REGULATION:

Regulator and Government would be under constant pressure from customers to reduce premium rates particularly in property and motor insurance business. They would also seek dilution of sec 64VB to pay premium later and increase in Bank Guarantee payment period.

The insurers would seek dilutions in various norms especially solvency norms, investment write off guidelines and expenses of Management limits.

The Regulators needs to keep close watch on the financial soundness of Insurers in the context of economic stress. This is essential to take care of the interest of policyholders.

NEW NORMAL OF BUSINESS OPERATIONS:

The Insurance sector will have to adapt itself to the new way of doing business. Contact free society / economy will be the new norm.

More digital has to be used for soliciting and servicing business. Agents and intermediaries have to be fully digitally enabled to procure and service business.

Claim assessments would pose complexities due to difficulties in physical verification. Digital technology has to be used both by insurers and surveyors for loss assessments. Delays in claims intimations would happen especially during lockdown period.

Lockdown and longer social distancing norms would necessitate change in the method of functioning of offices.

Online, video/audio conferencing, digital meetings will become the new norm.

CONCLUSION:

The Covid-19 outbreak is a nightmare turned reality. None would have expected such a situation. Yet, mankind has persistently adapted itself to emerging realities and forged new solutions that address new challenges. It is to be hoped that there is light at the end of the tunnel, and that the tunnel is short.