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COVID-19: UK industry focus

Where next for insurance?

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Where we are today

COVID-19 has done more to raise public awareness of the role of insurers than possibly any other event in our lifetimes. But it has also shone a light on the limitations of policy coverage, and customer understanding of these limitations, particularly regarding those risks that no individual or business had envisaged.

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Most media coverage to date has naturally focused on potential claims from business interruption cover. However, some classes, such as personal motor, are seeing significantly reduced claims volumes, while others are incurring more immediate and certain pain. Mortality will affect life insurers, and pay-outs related to cancelled or postponed events (such as UEFA Euro 2020 and the Olympic Games) will create significant costs for general insurers, as will pay-outs as a result of holiday and business travel cancellations, shareholder litigation and insolvencies.

Furthermore, insurers' capital strength will suffer as a result of falling asset values. Many insurers will have seen significant losses on their corporate bond allocations. Lloyd's, for example, has approximately 35% of its asset allocation in corporate and non-EEA sovereign bonds, which have seen losses of around 10%, reducing the buffer on its market-wide solvency ratio by a third between December 2019 and mid-March 2020.

COVID-19 will also impact customer attitudes. Customers may become more discerning buyers of insurance and, as such, the quality of the services offered and the way providers use technology to enhance these will become critical. They will potentially seek different propositions, too; for instance, health insurers have noted that demand for their support services has spiked by up to 150%.

But these challenges can be a catalyst for positive change and a stimulus for the sector to reassess and reshape. Insurers need to address legacy problems with a new sense of urgency and position themselves to meet future challenges with greater resilience and agility.

150%

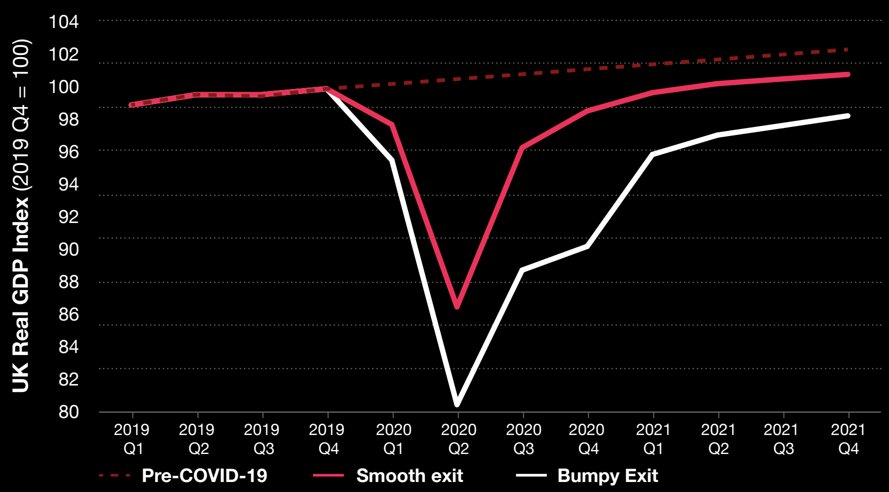
increase in demand for health insurers' support services

Lower, for even longer

Even before COVID-19, the insurance sector was facing considerable macroeconomic pressures. Since the 2008 global financial crisis, interest rates have been at historic lows in many countries. As a result, squeezed investment income has meant general insurers have had to focus even more clearly on underwriting profit to prosper. Their success has been dependent on having better technical pricing models than peers, more transparent and variable cost bases, and the best possible talent and leadership.

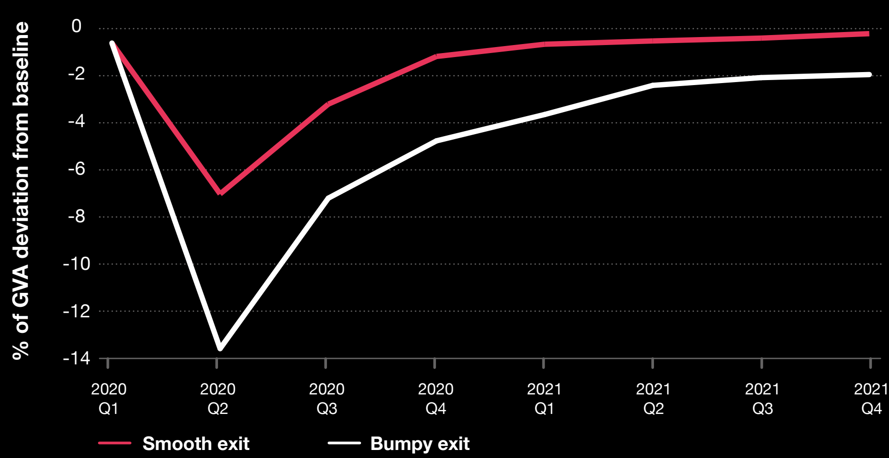
This is likely to continue, compared to our projection for growth in a pre-COVID-19 scenario. As global economies grapple with the macroeconomic fallout from the current crisis, interest rates are likely to remain pinned to the floor.

Comparison of Real GDP Index by scenario and pre COVID-19*



*Relative to baseline projection
Source: Strategy& UK Economic Analysis April 2020

Impact of COVID-19 on Insurance GVA by scenario



Source: Strategy& UK Economic Analysis April 2020

Against this challenging backdrop, insurers will have to refocus on transforming and digitising their operating models to build in flexibility and agility, as well as maximising new income streams.

Beyond that, the COVID-19 crisis will increase pressure on those challenges that have existed for some time. The battle to recruit and retain talent will remain paramount to deliver the future changes required.

139,000

Current no. of sector employees

'Total number of employees' represents the total number of employees in the Insurance sector. These figures are deduced from ONS, specifically the Business Register and Employment Survey 2018 provisional.

Medium

Jobs at risk RAG rating

'Jobs at risk' rating reflects the analysis conducted by the International Labour Organisation. They assessed the global impacts of COVID-19 on different sectors, assessing those most likely to lay off workers due to lower cash flow.

30%

of workers who normally come into physically close contact with >20 fellow workers

Physically close contact is defined as a distance of 2m. Source: PwC Research QuantiBus April 2020.

67%

of workers that can work from home

The Work From Home index is based on a survey carried out by PwC Research, and is the equivalent to the % of respondents saying they can work from home.

What are we learning?

Policy wordings come under greater scrutiny

As the Financial Conduct Authority has pointed out, most business interruption policies do not cover pandemics and have no obligation to pay out in relation to COVID-19. The current outcry against insurers does not take into account that pandemics impact 'all people' and traditional risk pooling cannot apply. But no doubt, given the sheer size of the costs at stake, there will be disputes and legal actions around the interpretation of some exclusions and extensions, such as 'denial of access' clauses.

Legal challenges to insurers' interpretations of wordings and exclusions could lead to drawn-out proceedings and negotiations. In some countries, retrospective legislation on business interruption claims, and regulatory interventions, could reverberate for years.

In this regard, government intervention has become a real possibility. In the US, for instance, New Jersey is considering a bill which would retroactively change business interruption insurance policies to eliminate virus-related exclusions, forcing insurers to cover COVID-19 losses. Governments or industry players will need to take learnings from previous market interventions to develop innovative solutions, such as a 'Pandemic Re' on the model of the UK's Flood Re, that minimise the impact from future systemic risks such as pandemics, whether at a national, regional or even global level.

Early technology adopters benefit from greater resilience

Extreme pressure has been placed on call centre operations, highlighting a lack of resources and technology to cope in unprecedented circumstances, particularly with respect to flexible working practices. With most insurers having limited surge capacity, call waiting times have extended, much to the frustration of customers already dealing with high levels of stress. Some insurers spent the first three weeks of lockdown just trying to procure and courier hardware to resolve remote access issues.

Temporary closures of offshore support centres have aggravated the situation. Those insurers that have already equipped all employees for flexible working and adopted technology-enabled customer triage will be best able to maintain services throughout the crisis.

Likewise, those who had already fully digitised their client and customer propositions have felt less impact in their sales volumes.

“The current outcry against insurers does not take into account that pandemics impact 'all people' and traditional risk pooling cannot apply.”

Brand and reputation can make or break a business

The crisis has highlighted the vulnerability of insurers to reputational damage. Repudiated claims, even if fair by the letter of the policy, could have serious implications for a company's public perception.

On the flip side, a positive and proactive approach can go a long way. For example, Geico in the US has already credited car insurance customers with refunds for premiums on vehicles not used during lockdown. Here in the UK, insurers that provide telematics with their motor policies lower premiums automatically for drivers with reduced driving times; those insurers are likely to protect their reputations. Others have recognised conduct risk concerns by ceasing sales or renewals of policies that would be of limited use to policyholders because of issues such as travel restrictions.

Such timely, focused interventions show how COVID-19 is reinforcing the importance of clear and fair communications in retaining customer trust.

Employee support can be a business's greatest defence

When revenue streams are imperilled, it is easy to underestimate the importance of maintaining a positive corporate culture.

Without the infrastructure from office life and established workplace social networks, management teams have been challenged with finding new ways to engage and motivate their employees. As such, COVID-19 may, in the longer term, drive insurers to rethink their operating models to prioritise flexibility and agility and be more aware of the needs and expectations of their workforce.

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> This pandemic must serve as a catalyst for insurers to reassess their operations, technology infrastructure and physical locations, as well as revisit their strategies.”

How do we respond?

The COVID-19 crisis will have a severe and immediate impact on the scope and scale of claims, policy wordings, top-line growth, insurers' capital bases and their investment returns. Insurers now need to think about how to learn from this setback and ensure greater resilience in the future.

Flexibility is not just a nice-to-have

COVID-19 has tested the operational resilience of business models across all sectors.

Historically, few insurers have had the ambition for their in-house IT infrastructure to be a source of competitive advantage. But as cloud-based systems have become more prevalent, early-adopters may now be reaping the benefits as competitors with older systems struggle to embrace the flexible and remote working model needed at this time.

This pandemic must serve as a catalyst for insurers to reassess their operations, technology infrastructure and physical locations, as well as revisit their strategies. With employees being forced to work remotely, insurers must reassess their cyber defences and ensure data security is robust. COVID-19 heralds a new era for the Chief Operations Officers of insurance companies.

In addition, it has been a wake-up call for those insurers whose propositions were not yet fully digitally enabled.

£25bn to £30bn

is the UK's estimated protection gap

Prepare for the next challenge

Pandemics will now feature much more prominently in insurers' and clients' future risk assessments. In the longer term, this could lead to tighter wordings, more appropriate ratings, and an increase in monoline pandemic coverage. Any widespread reassessment of established policy wordings will also present a shift in the industry, where those nimble enough to adjust quickly will be better placed to win market share.

Insurers must now drive more comprehensive contingency planning, to reassess what the so-called 'worst-case scenario' might entail, and to model financial implications of other similar potential events they might previously not have considered.

In the medium to long term, operating models must evolve to meet new challenges and capture emerging opportunities. Lower returns on long term investments will increase competition in already crowded markets. Some insurers may consider divesting to remain afloat. Others will look to diversify into new markets and products.

Tune in to changing customer needs

In the coming months and years, demand for insurance from individuals and businesses will be shaped by the economic backdrop. Considering the likely timescale for economic recovery, we anticipate a reduction in short term demand for insurance.

In the longer run, however, we expect consumers and businesses to reassess their attitude towards insurance and reconsider the risks to which they have been exposed. They might never have previously considered the possibility of a pandemic posing a risk to their lives or livelihoods.

This is an opportunity for insurers to reset customer perceptions.

In the past, insurance has been viewed as a mandatory or commoditised purchase, but in the wake of the damage wrought by COVID-19, customers may be more proactive in purchasing insurance and more selective when choosing an insurer, paying closer attention to quality and coverage, brand and reputation.

This new awareness and engagement with insurance is an opportunity that insurers should use to establish and secure a competitive advantage. Could this be the trigger the industry needs to make real headway into the UK's £25bn to £30bn estimated protection gap, when for decades they have struggled to do so?

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The opportunity for insurers

Insurers face immediate challenges, from unfavourable publicity and reputational damage, to changing demand patterns and new risks from a more interconnected world. The needs of yesterday are not the same as the needs of tomorrow.

This presents a unique opportunity to help consumers and businesses see the risks they face in a new light. As a country and globally, our protection gap is not showing signs of reducing, and it is potentially even growing. To take one obvious example, we need solutions to better manage the risks from future pandemics. Insurers and governments have solved market-wide underinsurance problems before, for example, through Pool Re or Flood Re. While a pandemic presents a more systemic risk to the global economy, a combination of business resilience investments, government and industry support, and insurance risk transfer products should help us recover more quickly from subsequent pandemics.

Despite immense uncertainty, insurers should treat COVID-19 as an opportunity to reflect on their current strategies and positioning, assess the agility and resilience of their operations and contingency planning, and reconsider priorities, even as they head into an unpredictable future.

Insurers now have the chance to craft wider insurance solutions to pandemic risks, strengthen their reputations and deliver vastly improved propositions and efficient operations for customers.

Who to talk to

Ainsley Mayhew Seers
Partner, Strategy&
+44 (0) 7711 562493
ainsley.mayhew.seers@pwc.com

Andrew Kail
Partner, UK Leader for Financial Services, PwC
+44 (0) 7703 459443
andrew.kail@pwc.com

Christine Korwin-Szymanowska
Partner, Strategy&
+44 (0) 7984 567298
christine.korwin-szymanowska@pwc.com

Jim Bichard
Partner, UK Insurance Leader, PwC
+44 (0) 7841 562560
jim.bichard@pwc.com

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