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ViewPoint

Analyzing Industry Issues from an Independent Perspective

COVID-19 Series

Navigating the Great Unknown: What Will P&C Industry Premiums Look Like?

Given the unprecedented nature and yet to be seen full scale of this pandemic, with respect to duration, severity, and the potential for unfavorable legislative edicts, 2020 will be a very unsettling and unpredictable year for the P&C industry.

Nevertheless, Holborn has evaluated the available, yet still changing, research, statistics, and economic forecasts in an attempt to capture and quantify the financial impact of COVID-19 on 2020 U.S. Property and Casualty In-force Net Written Premium (NWP).

From a larger perspective, the following historical changes in P&C NWP growth helps inform our thinking.

Sept. 11th Attacks (2000 to 2001)	Financial Crisis of 2008 (2007 to 2009)
+3.4%	-3.5%

April 16, 2020, IMUA and AIMU, "COVID-19: Economic Impacts on the P&C Insurance Industry Overview and Outlook", Robert P. Hartwig, PhD, CPCU

> **"Whatever number we come up with today is going to be wrong. It's going to be higher or it is going to be lower.**
>
> *Chris Williams, Tokio Marine*

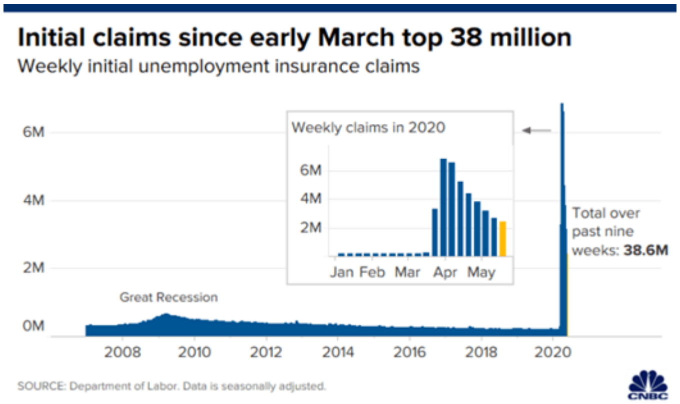
While the exact estimate is hard to quantify, at the moment, there are several insights to glean from macroeconomic information, as well as some additional historical experiences in the industry.

Macroeconomic Insights

On a more granular basis, the following macroeconomic foundational assumptions are helpful in assessing the impact of COVID-19 on the insurance industry:

US Real GDP: While this figure decreased for the first quarter of 2020 by -4.8% and by a further -37.7% in the second quarter of 2020, according to the Congressional Budget Office (May 2020), U.S. Real GDP growth will be positive during the third and fourth quarters of 2020 (+21.5% and +10.4%, respectively), as well as remaining positive during 2021 at a 4.2% annual rate. This implies good news for the P&C industry as economic activity rebounds across the country and exposure growth returns.

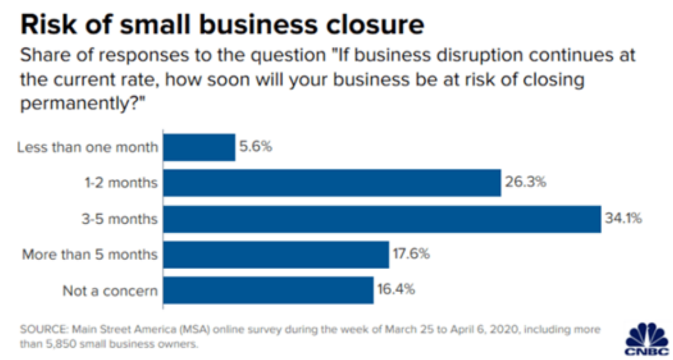
Rising Unemployment: Earlier this year, unemployment reached a historic low of 3.5% - qualifying as "full employment." However, according to April's employment numbers, the U.S. economy lost over 20 million jobs in April pushing the unemployment rate to 14.7%. The actual adjusted figure could be at least 5% higher based on how the figures are compiled; this is a fluid figure as demonstrated in the graphic below referencing updated figures on jobless claims through May 21st.



May 21, 2020, CNBC, "Jobless claims total 2.4 million, still elevated levels but a declining pace from previous weeks"

Consumer Confidence Index: The Consumer Confidence Index has plummeted, falling 45 points over March and April, and may have fallen more if it were not for consumers' belief in an imminent recovery. Consumers themselves account for roughly 70% of all spending in the U.S. economy. With stay-at-home orders gradually being lifted across America, consumer purchasing activity should begin to rise over the coming months.

Small Business Impact: COVID-19 has had drastic and potentially unrecoverable consequences for small businesses. According to April Research from Main Street America, under current lockdown conditions, 5.6% of small businesses cannot last more than one month, another 26% cannot last two months and another 34% cannot last between three and five months. In total, 66% of small businesses are saying they cannot survive for up to five months. Notwithstanding the U.S. government stimulus package(s) authorizing hundreds of billions of dollars in small business loans and another $250 billion in direct payments to individuals, the survivability of a significant portion of U.S. small businesses is at great risk under current conditions.



April 14, 2020, CNBC,"7.5 million small businesses are at risk of closing, report finds"

The Shape of the Recovery: Opinions regarding the shape of the recovery are largely varied and undoubtedly depend on how quickly the economy reopens and the effectiveness of Federal Stimulus in keeping businesses solvent. Given the historical strength and fundamental soundness of the U.S. economy, economists anticipate that the U.S. economy will begin to modestly recover during the third quarter of 2020.

Measuring the Impact to Net Written Premium

The most recent pre-COVID-19 forecast for 2020 NWP was included in *Best's Market Segment Report 2020 Review / Preview: US Property and Casualty* (March 2, 2020). Specifically, the following figures provide a basis for projecting NWP for 2020 in the wake of COVID-19:

- Estimated 2019 NWP of $643 billion
- Projected 2020 NWP of $668 billion, representing a 3.9% or $25 billion increase
- NWP growth is split 54% for personal lines and 46% for commercial lines

Based on the above, we can assume that the In-Force NWP as of end of first quarter 2020 (i.e. before any impact of COVID-19) is approximately $650 billion, matching a quarterly projected pace of 3.9% or +$7 billion. The split of this premium at end of first quarter 2020 is approximately $350 billion for personal lines and $300 billion for commercial lines.

Personal Lines

Estimated In-Force NWP of $350 billion at the end of first quarter 2020 can be further assessed by line: approximately $250 billion for Private Passenger Auto and $100 billion for Homeowners & Farmowners. The estimated impact to these lines from COVID-19 is:

Personal Auto: In March and April of 2020, private passenger auto use has decreased drastically. Early evidence indicates that auto accident frequency is down; however, there are confused signals about whether severity is up or down.

As of May 2020, auto writers have already returned over $10.5 billion of premium to their policyholders for the months of April and May, which could grow with lengthened stay at home orders. This return represents a 4.3% two-month risk reduction credit. Assuming there are no further premium returns this year, the entirety of the expected 2020 NWP growth for auto has evaporated.

Homeowners & Farmowners: We have yet to see any company publicly commit to giving a pandemic risk reduction credit to their policyholders. Arguably, property and liability exposures are higher now with people under stay-at-home orders and potentially unemployed. At this time, it is too early to know what, if any, impact mortgage delinquency or default rates might also have on this line of business. Therefore, it is too early to assume anything but static premium for these lines.

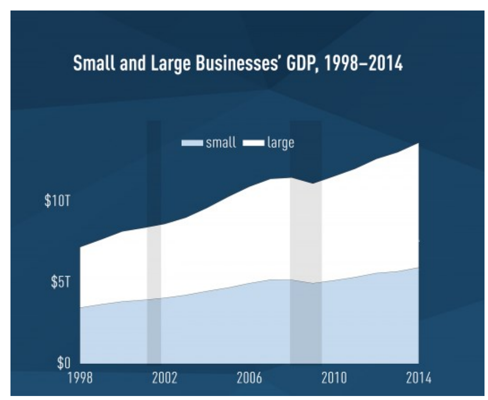
Commercial Lines

Commercial Lines are much more sensitive to economic conditions and more directly tied to the impacts of the COVID-19 response. With pricing tied to metrics like revenue and payroll and with the variety of business segments (i.e. hospitality & leisure, transportation, manufacturing) impacted differently, estimating the impact to NWP is particularly difficult at this time. The following represent best estimates based on what is known at this time.

Workers Compensation: Workers Compensation represents about 7.9% or $51 billion of 2020 In-Force NWP. Leading up to the pandemic, rates for this line had been decreasing in many jurisdictions. Unfortunately, this line of business is mostly rated on a company's payroll and payroll has diminished through unemployment or furlough. How quickly premium for this line will return is directly correlated with how quickly we repopulate the workforce. According to Robert Hartwig, Workers Compensation premium will shrink between 12.5% and 25% due to the pandemic. This translates to a reduction in In-Force NWP of approximately $9.5 billion if we consider the answer is in the middle of the range.

> **"Payroll exposures are taking a huge hit leading to a large impact on workers comp premiums written**
>
> *Robert P. Hartwig, PhD, CPCU*

CMP, Fire, Allied Lines: Commercial Multi-Peril ($40 billion) and Fire & Allied Lines ($35 billion) account for $75 billion or 11.6% of 2020 In-Force NWP. The COVID-19 response has forced a majority of small business to close their doors, with many expected to go out of business. With less of an ability to pivot and less capital to draw upon, these lines may be more heavily impacted by the decline in small businesses. According to the SBA, small businesses represent nearly 44% of GDP. But, small businesses require substantially lower limits of protection. As noted previously, 66% of small businesses project they cannot survive for up to five months. As the economy opens, however, newer businesses may emerge. Taking these into consideration, In-Force NWP could decrease by 10% or $7.5 billion, which may still be an optimistic estimate.



Dec 2018, US Small Business Association, Office of Advocacy

Commercial Auto: Commercial Auto has been challenged with profitability and was problematic pre-COVID-19 (e.g., scarcity of experienced drivers, accident frequency and severity increases, and social inflation) accounts for 6.7% or $43 billion of 2020 In-force NWP. NWP may remain flat for commercial auto when accounting for the corrective rate increases flowing through this line of business in 2020 offset by exposure reductions.

Other & Products Liability: Other and Products Liability represents 10.1%, or $65 billion, of 2020 In-force NWP. This category includes D&O, EPLI, Excess Casualty Umbrella, and General Liability. On May 12, 2020, Robert P. Hartwig, expressed in his NCCI keynote address that 2020 In-force NWP General Liability premiums could decline between $1.5 billion and $6.3 billion, $4 billion representing a figure in the middle of this range.

Too early to tell: Other lines represent a greater unknown as it is too early to quantify. For now, premiums are estimated flat for Inland Marine ($15 billion or 2.4%), Medical Professional Liability ($9 billion or 1.4%), and all other lines like ocean marine, aircraft, fidelity, surety, and boiler/machinery ($47 billion or 7.3%).

Potential Impacts of COVID-19 on Written Premium in 2020 by Key Line

Line	Estimated Impact
Workers Compensation	12.5% to 25% reduction in premium written in 2020 ***(equates to $5.9B to $11.75B DWP)***
Business Interruption & Contingency	7% to 13% reduction in premium volume
General Liability*	$1.5B to $6.3B reduction in premium
Personal Auto	~$10B in refunds, rebates (equates to ~4% of DWP)
Personal Travel Insurance	29% to 78% reduction in premium written

*Includes nursing home professional liability.
Source: Derived from Willis Towers Watson, *Scenario Analysis of COVID-19 Pandemic* (Fig.11), May 2020 and other sources; Risk and Uncertainty Management Center, University of South Carolina.

AIS VIRTUAL

May 12, 2020, "Coronavirus and the Recession of 2020—What It Means for Workers Compensation"

The Bottom Line

At the end of first quarter of 2020, we estimate In-force NWP is approximately $650 billion. When we combine the personal lines private passenger auto two-month risk reduction credit of $10.5 billion with our estimated $21 billion negative NWP growth across the key commercial lines identified above, we calculate the 2020 U.S. Property and Casualty In-force Net Written Premium could shrink by approximately $31.5 billion. As such, instead of growing by $25 billion or 3.9% and reaching $668 billion, the U.S. P&C NWP industry might shrink by approximately $31.5 billion or ~4.8%, to around $618.5 billion.

As of now, it looks like we could lose almost two years of U.S. Property & Casualty Net Written Premium growth.

Headwinds and Tailwinds in the Estimate

We appreciate that we are in the very early stage of our economic recovery and that actual results may vary widely from those estimated here as there are many variables at play including:

- Uncertainty surrounding the length of the lockdowns
- The number of ultimate business failures
- Consumer savings and purchasing behaviors
- The potential for a "second wave" of the virus which may necessitate further lockdowns
- Additional congressional-approved stimulus programs and actions by the Federal Reserve
- Rebound / Recovery speed
- Higher unemployment

Insurance industry responses will influence these figures such as:

- Actual COVID-19 insured (or mandated) losses
- Future coverage for pandemics via Pandemic Act, new products or coverage definitions
- Predicted active Atlantic Hurricane Season
- Growth in new products like Cyber
- Response to Asset hit
- Shifting exposures

The figures above reflect industry thoughts as of late May 2020. Undoubtedly the final industry NWP figures will change as circumstances change.

Conclusion

Holborn will continue to monitor the impact of COVID-19 on the insurance industry. Keeping an ear to the ground on the various aspects of this event will help our clients succeed.