Life in the Time of Corona

COVID-19 and its Impact on Life Reinsurance

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About a year ago, first rumours about a minor outbreak of a new infectious disease in Wuhan emerged. This was less than 12 months ago.

Since then we have experienced first-hand how a single disease can dramatically change the way we live and work. The previously rather academic notion of a major pandemic has become very tangible. Social distancing, mask wearing and sustained work from home are no longer just concepts, they are a daily reality. Many of us know people who have been infected, some of us have become ill themselves or even have lost loved ones.

It can be argued that many things could have been done better, but in most countries the reaction to this enormous challenge has been – by and large – remarkably good. Let's just take the example of medical research and technology. The genome of SARS-CoV-2 was sequenced and published just days after the virus had been identified. A first test kit was available a couple of days later. The development of vaccines and therapeutics is running at unprecedented speed and is showing some first promising results. Tracing apps have been introduced and are in active use.

But still, by now more than one million people have died from the virus – and that doesn't count the casualties from the indirect consequences of the pandemic like overloaded medical facilities. And it is far from being over. In many countries we see a massive new surge of corona infections which could collide with a less benign flu strain than the one we had during the last season.

But let's come back to the main question of this article: How does this pandemic impact the Life reinsurance industry? Many pandemic models focus primarily on the shock effect of a pandemic on Mortality portfolios as the main driver of losses for reinsurers. But is this really that relevant this time? Let's have a look at the various areas affected by COVID-19.

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The Mortality portfolios of Life reinsurers have been affected immediately – but to a lesser degree than the standard pandemic models predict. This is because the virus has the most severe impact on older people and those with pre-existing conditions, persons who tend not to have extensive mortality insurance coverage.

The mid-term consequences of this pandemic, however, are more concerning. Why is that? Firstly, the lasting effects of the virus on the human body are still puzzling the medical experts and could adversely influence the health of the COVID-19 patients over a longer period of time. Secondly, the socio-economic implications of the pandemic (e.g. increased poverty and less funding for healthcare systems) are likely to have a negative mid-term impact on the life expectancy of the population.

For the same reasons, Longevity portfolios will probably provide material diversification benefits to Life reinsurers. This is especially true because the main Longevity reinsurance markets, the UK and the US, have been hit hard by COVID-19.

But what about the Morbidity books? For Critical Illness, the outcome is unclear and might simply be neutral. Much more worrying is the future claims development in Disability. There is likely to be a negative influence from anxiety and social isolation on mental health. Experience also indicates that high unemployment rates lead to increased claims ratios in Disability (which is a line of business exposed to moral hazard) – and we already see materially higher unemployment in many countries as a result of the economic impact of the pandemic.

And then there is the asset side. Obviously, the valuation of investment portfolios has taken a substantial direct hit, but we have seen a rapid recovery of the stock markets since then. To what degree this recovery is sustainable remains to be seen though. The actions of central banks will lead to even lower (or negative) interest rates – and they can be expected to be around for some time. This will further increase the pressure on reinsurers that have written covers with long-term interest rate guarantees.

Overall, however, I have no doubt that the Life reinsurance industry is well positioned and financially strong enough to weather this storm. COVID-19 will spark changes in the industry ranging from a review of capital requirements, over adjustments to our pricing and reserving bases to new risk solutions addressing the lessons learned during this crisis.

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We've also experienced a massive change in the way we work and collaborate. This is not going to go away, and companies with a strong and flexible technology platform and an open communication culture are likely to benefit from this change.

On the market side, COVID-19 has obviously led to a higher awareness of pandemic risk which is driving the demand for effective reinsurance solutions. We already see that the prices for pandemic covers are recovering from the unsustainably low levels of the last years. On the other hand, we can expect that reinsurance structures are going to be under much more scrutiny regarding their effectiveness in a pandemic situation.

When it comes to the pricing of trend risks like longevity and long-term mortality and disability covers, I think that the jury is still out. There is just too much uncertainty regarding the lasting effects of the virus.

So, what is the bottom line of all this? I believe that Life reinsurance portfolios will incur a material financial hit, but in different ways than anticipated – and it's not an existential threat to the industry. COVID-19 will change our way of looking at pandemics and it is likely to drive demand for effective risk solutions.

Most importantly, we need to be clear about one thing: this is not over. We have just weathered the first wave of this storm. This virus is making its comeback and it might be here to stay. We better be prepared.

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