COVID-19: Issues in insurance regulation

Insurance regulators spend a great deal of time on activities designed to insulate their insurance company charges from instability. That is a difficult objective in the best of times, but when economic shocks, such as the current virus plague, turn up, it becomes even more challenging.

Reinsurance plays a key role in cushioning insurers from economic shocks, -- but only if the reinsurers themselves prove capable, and willing to, step up.

Having access to a diverse and international pool of reinsurers benefits the cedent when localized catastrophes strain the cedent’s resources. But a pandemic turns the tables: when many of the reinsurers are exposed to the same global catastrophe as has beset the cedent, the cedent may find that his reinsurers are in no better position to pay claims than he is. Nevertheless, reinsurance, including (and even especially, non-admitted reinsurance, offers an important degree of protection to risk-bearing Americans.

In previous cycles, distrust of the credibility of reinsurers in far-off lands led some regulators to pressure US cedents to “cash out” treaties, especially those with non-admitted counterparties, at a steep discount via commutation. In some cases, these commutations avoided catastrophic loss for the cedents, especially those who were alert enough to move early. But in hindsight, it was often a mistake. The cedents’ own loss estimates have sometimes proven optimistic, leaving them unprotected against loss development the reinsurers would have shared. The lively market that developed for “run-off” operations is an indicator of how much money those commutations left on the table.

Memories in insurance regulation are not always long, and a new generation of insurance regulators now mans the US insurance ramparts. A generational change has introduced new commissioners, deputies and analysts to the industry, and memories fade. Notwithstanding the human impulse to distrust foreign capital, it is imperative that those regulators understand the value of reinsurance, to the survival of their companies in difficult times, and the value of geographic diversity in reinsurance. If it does no other good, the COVID pandemic may provide a refresher course in the importance of maintaining insurers’ access to a broad base of reinsurance capital.
Insurance regulators see their first responsibility as the protection of the insured public from misconduct or irresponsible behavior by insurers.

Misconduct in this context covers a multitude of sins, but most of them fit into three categories:

- **Overselling** – marketing on a basis which elicits false and unrealistic expectations of the offered coverage;
- **Underdelivering** – inept, improper, or delayed claim handling, leading to failure of prompt settlement or denial of valid claims,
- **Hazardous operation** – a business plan (or lack of one) that exposes the insurer (and more importantly, its insureds) to an unreasonable degree of risk that the insurer will be unable to promptly and fairly settle claims, or response to potential loss events which, while protective of the insurer, amounts to a failure of performance of contracted obligations.

Regulators view reinsurance as part of the insurer’s system of protections against failures arising out of large loss events. Done well, their supervision of insurers includes the imposition of requirements that, if an insurer bolsters its apparent solvency by ceding
reinsurance, that the reinsurance, and the reinsurer, are of a kind and quality that can
survive a catastrophic claim scenario, and will, in fact, perform timely and fully. There is
an inevitable tension between the regulator’s risk aversion and tendency to back-seat
drive, and the insurer’s desire to respond nimbly and profitably to opportunities that carry
risk.

The responsibility regulators like least, however, is their duty to ensure that, if a disaster
so large as to threaten the survival of an insurer, or even a whole category of insurers,
that the policyholders and claimants are treated equitably and receive, if not exactly what
they are entitled to, then at least a fair share of the insurance company’s pot. This long
and often painful process will almost certainly snare both insurers and reinsurers who
may have underestimated their exposure to pandemic risks.

In advance of disaster, many plans can be made, wording arranged, and reserves set aside
which, in theory, should be adequate to ensure that the insurer has made only promises it
can keep, and has provided itself with the means to do so. But when it comes to very
large, infrequent or unheard of loss clusters, that theory may prove wrong. COVID-19
may prove to be, for some hapless insurers, a non-survivable event.