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Spike in Pandemic-Related Claims for Taiwan's Non-Life Segment

The COVID-19 pandemic puts non-life insurers' underwriting risk control and risk accumulation management to the test

Taiwan's COVID-19 policy may lead to a capital event for some non-life insurers, while others potentially face an earnings event for 2022. Based on the Financial Supervisory Commission's (FSC) analysis, an industry stress scenario with the assumption of a 15% infection rate could lead to ultimate gross losses exceeding TWD 41 billion (USD 1.39 billion) against the market's adjusted capital base (including special reserves for non-compulsory auto liability insurance [CALI] business) of TWD 175 billion (USD 5.91 billion) as of year-end 2021. However, part of the losses will be covered by the reinsurance market.

Principal Takeaways

- Ultimate industry losses remain highly uncertain as it depends on the infection rate especially over the next two months, as well as potential government policy changes.
- The magnitude of impact on individual companies varies widely and is dependent on underwriting exposures relative to its capital size, policy terms and conditions, reinsurance strategies, and risk accumulation management.
- Insurers that face capital pressure are likely to withstand this difficult period, backed by capital support from their parents.
- Companies that are less impacted are expected to recoup their pandemic related underwriting losses over the medium term due to a track record of profitability from traditional non-life business.

COVID-Related Claims Rising Fast

Taiwan's non-life insurance segment is experiencing a spike in claims due to the resurgence of COVID-19 cases since mid-April. According to FSC statistics, the total number of in-force pandemic insurance policies is currently estimated at approximately 7.6 million, relative to a population of 24 million. Of these, 5.1 million in-force policies were underwritten in 2021, before the prolific spread of the Omicron variant; 2.5 million policies were sold this year, while more than one million new and renewal policies are still pending underwriting. As of 6 June 2022 year-to-date, the total product premiums received are estimated at TWD2.8 billion (USD95 million), while total gross claims paid have reached TWD5.5 billion (USD186 million), with an average payout close to TWD35,000 (USD1,190).

The pandemic policy gained significant traction when it was introduced in early 2021. Following the wave of Delta-strain infections in May 2021, the product continued to gain popularities with more insurers offering their products to capture new business throughout 2021. When the Omicron wave began to spread rapidly in Taiwan in April 2022, most insurers either immediately ceased product sales or replaced their fixed indemnity product with a reimbursement based product. As per the FSC's latest update, apart from 12 vaccine products still available in the market, all pandemic products have been withdrawn.

The direct premium written (DPW) for both health insurance (including in-patient medical costs) and other property insurance (including fixed indemnity payments when

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policyholders face quarantine requirements) rose by almost 100% in 2021 relative to 2020. These two product lines accounted for less than 10% of total DPW (excluding CALI) in 2021.

The pandemic product of concern is an annual, fixed indemnity cover for those who are classified as having contracted COVID-19 or close contacts of COVID-19 patients. The fixed indemnity payout for policyholders who have contracted COVID-19 can range between TWD30,000 (USD 1,000) and TWD 100,000 (USD 3,380), while the nature of the fixed indemnity product allows for simple administration on the insurer's part.

Fast-Changing Risk Exposures a Challenge

AM Best notes that the mismatch in insurers' ability to adjust risk exposures from the pandemic is a major driver of a potential capital event from this new product, which only accounted for a small proportion of the underwriting portfolio.

Taiwan has managed to defend itself well from the pandemic over the past two years, adopting a zero-COVID policy. However, with the swift spread of the highly contagious Omicron variant across Taiwan, the government has shifted its zero-COVID stance to a live-with-COVID policy. To ease the healthcare burden, polymerase chain reaction (PCR) tests are no longer required to confirm COVID-positive cases. The government has urged patients not to visit hospitals for the sole purpose of obtaining medical certificates of diagnosis for the processing of pandemic claims; the Non-Life Insurance Association of the Republic of China has also agreed to accept digital COVID-19 certificates as valid proof of infection. But this decision was not well received by market players as it posed a greater risk of moral hazard and fraud, which could inflate the total claims payout.

Impact on Industry Players Vary

Nonetheless, AM Best believes the financial impact to individual rated companies vary depending on their underwriting risk control and risk accumulation management. Factors that differentiate between companies facing a potential event and companies impacted to a limited extent include:

- Tight policy terms and conditions – While the pandemic product policy features are broadly similar, offering low limits, small tweaks in terms and conditions or the addition of exclusion clauses could have materially lowered potential losses. The looser the terms or more generous the coverage, the larger the potential loss faced by the company.
- Well-aligned underwriting strategy and reinsurance supply – Reinsurance is commonly used to mitigate the risk of new products with little underwriting history. As reinsurer capacity offering materially decreased after spread of the Delta strain in Taiwan, some insurers had scaled back their underwriting appetite in pandemic policies to manage risk accumulation.
- Timing of in-force business expiry – Insurers with a majority of their in-force book sold during 2021 which are expiring soon are likely to face a smaller risk in the development of COVID-19 in Taiwan given that product sales have ceased. Conversely, companies that have renewed or underwritten a large number of new policies before their recent discontinuation are likely to face greater uncertainty as they are obligated to service the unexpired contracts until 2023.

The Path Ahead

As such, AM Best expects that the ultimate industry claims remain highly uncertain as they are subject to the ongoing development of the pandemic situation, the potential emergence of new and more contagious variants over the next few months, as well as any changes to the government's policy on handling COVID-19.

The Taiwan government recently adjusted its quarantine policy, stipulating that close contacts of patients who are fully vaccinated can opt to receive medical monitoring rather than be placed on mandatory quarantine. This would help to lower the indemnity payout for quarantined cases.

Another major potential game changer, albeit yet to be decided, will be the government's downgrade of COVID-19 from the current tier-5 pandemic classification to tier-4. Depending on the policy terms and conditions, this could potentially lower claims payout materially, which could save insurers from a major capital event.

Favourable Operating Performance and Strong Parental Support

Earlier in March 2022, AM Best issued a commentary, *"COVID-19 Claims Put Thai Insurers Under Pressure"*, addressing a similar situation which arose in the Thailand market that has led to five insurers ceasing operations to date. Notwithstanding, the operating performance of Taiwan's non-life segment has been strong over the past five years, which has supported the gradual strengthening of insurers' capital positions through earnings accumulation. In addition, AM Best notes that the market has a stronger risk-adjusted capitalisation buffer. The simple average risk-based capital ratio of Taiwan's non-life industry as of year-end 2021 was 535%, significantly above the 200% minimum threshold.

Overall, non-life insurers' five-year average combined ratio was 95% (including CALI), while the return on adjusted capital and surplus (including special reserves for non-CALI business) remained in the low double digits from 2017 to 2021, according to AM Best's calculations.

Although the industry loss ratio of the pandemic products as of early June 2022 has already exceeded 100%, AM Best expects that the industry's total claims will continue to rise and add underwriting loss pressure on non-life companies for the full year of 2022, including insurers that do not see this leading to a capital event. Nonetheless, AM Best expects the industry to continue maintaining its focus on profitability and be able to achieve operating margins for non-COVID business, similar to levels prior to the surge in COVID-19 infections. AM Best notes that the companies that are less impacted are likely to recover from their pandemic-related losses over the medium term.

For insurers that may face capital erosion pressure, many of them have financial holding companies as parents or major financially strong shareholders. AM Best expects that they will receive capital support and benefit from their parent's financial flexibility to withstand the difficult year.

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