Pandemics: worse than terror?

David Spiller asks if it will take a global pandemic for the insurance industry to give enterprise risk management (ERM) the attention it deserves

David Spiller is president and chief executive of Guy Carpenter.

By the end of 2006, all four major rating services required an inclusion of enterprise risk management (ERM) in their rating process. To respond to this development, Guy Carpenter has developed dedicated service units to assist clients in this new field. While we find that clients have responded to the 'stick' of the rating agencies, they would also like to have some 'carrot' incentives. For life and health insurers, a global pandemic provides an ideal case study for dealing with the question, "Why ERM?"

Guy Carpenter's parent company, Marsh & McLennan Companies, has identified pandemic as one of the six critical risks facing businesses globally. The World Economic Forum for 2007 in Davos stated that "the world's ability to react to a global pandemic remains woefully underdeveloped".

While no private-sector enterprise is immune to the threat, the potential consequences of a pandemic are particularly grave for life and health insurers. For these, a pandemic would mean an unprecedented convergence of the four key categories of ERM: insurance hazards, financial, operational and strategic exposures. Insurers could be living amid the danger at the very time they have a pivotal role in managing and mitigating it. A pandemic event could derail current business operations, while forcing future strategies off course as well.

ERM's broad, systematic approach seems to hold the answers to the full load of risk factors associated with pandemic. Yet before we can get to all these answers, many questions must be asked. Our industry is working closely with thought leaders such as the World Health Organisation (WHO), Risk Management Solutions (RMS), the Rand Corporation and others to ask the difficult questions that will advance the understanding of, and the ability to manage, pandemic exposure.

As a result, strides are being made. Steps have been taken to identify and raise awareness of the drivers that can impact the pandemic risk of an insurer's portfolio. This includes gathering data on factors like geographic concentrations and insureds' occupations and socio-economic status, as well as an employer's readiness to manage a global outbreak. Such understanding is critical to align underwriting and steer risk-mitigation strategies consciously.

New models are enhancing our ability to understand and quantify the potential impact of various pandemic situations on a portfolio. One of the first, from RMS, enables pandemic scenarios to be examined based on variables ranging from disease infectiousness and lethality to outbreak location and accompanying vaccine production.

Insurers have viable options for transferring pandemic risk. Traditional reinsurance market capacity of at least $200m per occurrence is estimated as obtainable for the exposure. Thus far, both traditional excess-of-loss catastrophe-reinsurance programmes and adverse stop-loss treaties have been structured.

The path taken is decided largely by a company's confidence in its ability to prove pandemic as the cause of loss. Hybrid occurrence and stop-loss structures are emerging. Capital-markets solutions are being deployed as a supplement or an alternative to traditional reinsurance.

Progress has been made, but there is much more to be done. Companies must be diligent in preparing and updating plans to manage the operational risks of a pandemic. Our industry must continue to invest in modelling and analytical tools that will help insurance companies better understand and *anticipate* the exposure. There is the challenge of integrating underwriting strategies consistent with pandemic into traditional life-and-health underwriting practices and future growth strategies.

Then, layer on the complexity of the investment risk arising out of a potential stock- and/or bond-market crash. The events of 11 September 2001 demonstrated how a large-scale event can put pressure on investment markets worldwide.

Worst-case scenarios

Rating agencies and regulators, such as the UK's Financial Services Authority, have also begun to weigh in on this catastrophe exposure, assessing pandemic in terms of worst-case scenarios.

Finally, the application of risk-transfer solutions for influenza pandemic is still in its infancy. Many reinsurance markets and insurers maintain different frequency and severity assumptions surrounding a pandemic outbreak. As understanding of the risk grows, solutions can be more widely adopted.

The first human cases of avian flu (H5N1) were confirmed in 2004. Since then, there have been 274 human cases and 167 deaths reported, according to the WHO. WHO experts believe the world is now closer to another influenza pandemic than at any time in the previous four decades.

Although H5N1 is epidemic in poultry and wild birds, and has also struck humans, our nightmare scenario may not occur. However, as with many cards dealt to our business, it is not the likelihood of occurrence but the potential mortality rate that is so worrisome. With H5N1 reported to be fatal to more than half its human victims, the severity of an avian flu pandemic could be catastrophic.

Indeed, a full 84% of actuaries recently surveyed viewed pandemic as a worse catastrophic risk than terrorism. Let's not compound the tragedy by failing to prepare. It is time once again to face down the worst of risks. re

reinsurance

Editorial
Editor Mark Geoghegan
Reporter Mairi MacDonald
Sub-editor Jane Cahane
Art director Nicky Brown
Editor-in-chief Antony Gould
Editorial tel +44 (0) 20 7484 9933
Editorial fax +44 (020) 7484 9900
Email addresses name.surname@incisivemedia.com

Advertisement sales
Publisher Jonathan Trinder
Sales manager Graeme Roche
Advertising tel +44 (0)20 7484 9942
Advertising fax +44 (0)20 7484 9992
Email addresses name.surname@incisivemedia.com

Incisive Media
Group publishing director, insurance division Derek Peck
Group editorial services director David Worsfold
Managing director, insurance division Graham Harman
Marketing manager Ro Osborne
Group production manager Lorna Graham

Customer services
Tel (UK) +44 0870 240 8859
Tel (US) +1 (212) 925 6990
Email cs@incisivemedia.co.uk

Subscription hotline
Tel +44 (0)20 8606 7516
Fax +44 (020) 8606 7303
Email sigs@wdis.co.uk

Reprints and E-print enquiries: Richard Coury, The Reprint & Licensing Centre.
Email incisive@rl-centre.com
Tel 020 7501 1086

Annual subscriptions:
UK £225 Airmail
Europe £242 (€357) Airmail RoW £272 (€402). Remittances by cheque or international money order to be sent with order and made payable to Incisive Financial Publishing Ltd. Overseas cheques should be drawn in sterling.

Head office
Incisive RWG Ltd, Haymarket House, 28–29 Haymarket, London SW1Y 4RX
Tel +44 (0)20 7484 9700
US & Canada office
Incisive RWG Inc , 270 Lafayette Street, Suite 700, New York, New York 10012, US
Tel +(212) 925 6990
Asia & Pacific office
Incisive RWG Ltd, Unit 2708, 27th Floor, The Centre, 99 Queen's Road, Central, Hong Kong, SAR China
Tel +(852) 2545 2710

Average net circulation from 01/07/2005 to 30/06/2006: **9,298**

An incisivemedia plc publication

ISSN 0048-7171
Reproduction: CTT, London
Printer: The Grange Press, Southwick
Member of the Audit Bureau of Circulations