

# Box 1: Insurance Industry Performance During the Covid-19 Pandemic

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As a complement to the analysis presented in Chapter 2 for insurance companies with respect to the development of their portfolio, profitability, and capital adequacy, this box provides an account of the performance of insurance policies issuance, claims, and operational profitability by line of insurance in the aftermath of the Covid-19 pandemic.

During the pandemic, there was an increase in settled claims, especially for business lines (BL) of the life insurance group,<sup>1</sup> a trend that has reversed itself since February 2022. In contrast, the settled claims for the BL that make up the general insurance group decreased. Also, note that the first two peaks of Covid-19 deaths coincided with a slowdown in premium issuance which, together, resulted in a decrease in operating income, mainly for BL in the life insurance group.

Although the pandemic caused by Covid-19 had a negative effect on the profitability of the insurance industry due to the claims and lower revenue from premiums and a decrease in the value of investments, the industry has proven to be resilient and is currently on a trajectory of gradual recovery, which is evident in a decrease in claims, an increase in premiums, and in its technical and financial results for the year. The decrease in the occurrence of claims in the BL of the general insurance group may have helped to offset the losses caused by the increase in claims in the BL of life insurance. This suggests that the industry benefits from diversification.

In the future, the insurance sector could face some challenges related to: 1) the potential increase in the cost of settling claims due to factors such as currency devaluation and inflation; 2) the expected deterioration of the macroeconomic environment. This could have an impact on the creditworthiness of households and companies and thus affect the acquisition of new premiums and the payment of premiums for policies already purchased, and 3) the upward cycle of interest rates, which could affect its aggregated results.

## 1. Claims and premiums issuance

The Covid-19 pandemic generated different types of expectations regarding the performance of these two variables for the different BL of insurance.<sup>2</sup> On the one hand, an increase was expected in the loss ratio for the BL of life insurance due to the nature of the virus, and a decrease for those lines where claims would cease to materialize due to the social isolation measures experienced by the majority of the population (e.g. automobiles, compulsory insurance against traffic accidents (SOAT in Spanish), aviation, occupational risks, etc.). On the other hand, these restrictions could have led to a decrease in operating income, mainly represented by lower premiums for the BL of general insurance since the insured's risk would decrease, and there would be less interest in hiring new insurance policies.

\* The authors are part of the Financial Stability Department of *Banco de la República*. The opinions expressed here are the sole responsibility of the authors and do not imply any commitment on the part of *Banco de la República* or its Board of Directors.

1 The life insurance group consists of several lines of business such as: group life, collective life, individual life, health, personal accidents, disability and survivorship, funeral, etc.

2 Throughout this box, Covid-19 deaths in Colombia are used as a proxy variable for the intensity of the pandemic at each point in time.

Graphs B1.1 and B1.2 show the contribution of each BL to the annual growth of annualized settled claims (SC) and annualized premium issuance.<sup>3</sup> Since 2016, the year when detailed sector information began to become available by BL, no shock of the magnitude observed during Covid-19 pandemic had been recorded.

As shown in Graph B1.1, the growth of the SC surged shortly before the peak of Covid-19 deaths occurred in June 2021.<sup>4</sup> As was to be expected, group life BL<sup>5</sup> and disability and survivors' benefits BL<sup>6</sup> were the main contributors to this growth. Prior to the pandemic, these BLs showed a downward trend in their SC which then reversed as of December 2020 (second peak of deaths) and stabilized as of February 2022.

It is noteworthy that the contribution of health insurance to the growth of SC began to increase after the highest peak of deaths because once the lockdowns ended, individuals once again started going to medical appointments and were able to undergo other medical procedures (such as surgery and other treatments) that were again available. This increased the number of claims for this type of insurance.

The increase in the contribution from the BL of contractor all risk insurance<sup>7</sup> seen before the pandemic, in turn, corresponds to the indemnities made to *Empresas Publicas de Medellín* (insured) for the loss of *Hidroituango*, another of the major events that has affected the loss ratio throughout history.<sup>8</sup>

The insurance lines that presented the greatest declines in terms of SC were in BLs of compliance,<sup>9</sup> vehicles, and SOAT. Although, in the BL of compliance insurance, there was an increase in the SC for lease insurance, this was not enough to generate an increase in the total SC for that line compared to the pre-pandemic period.<sup>10</sup> In any case, by June 2022, lease insurance only accounted for 8.0% of total premiums written in the BL of compliance while compliance of contracts with state-owned entities accounted for 51.6%.<sup>11</sup>

With respect to premium issuance, there was evidence of a slowdown during the first two peaks of Covid-19 deaths. The BLs that contributed most to this reduction were Act 100 pensions (life annuities),<sup>12</sup> health, vehicles, SOAT, and occupational risks. This performance can be attributed to factors such as: 1) health insurance was not taken out due to the impossi-

3 Claims settled or paid are the value of claims incurred and paid by insurers. The reinsurance portion is not deducted nor are claims reserves included.

Premiums issued are the main income of insurers and represent the cost of the insurance coverage granted by the insurer for each policy issued.

4 The increase in SC occurs after the first peak of deaths, since these are registered some time after the loss occurs and the policy claim is made.

5 Group life is a BL that belongs to the groups of life insurance.

6 In this BL, the PFMs are the policyholders. The insurance covers the amounts necessary to complete the resources of the member's individual savings account required to finance the disability and survivor's pension.

7 This line is designed to cover construction projects. It covers damages suffered at the construction site due to fire, explosion, construction errors, short circuits, hurricane winds, floods, rain, etc.

8 This event only affected one insurance company that paid the claim in December 2019, September 2020, August 2021, and January 2022 with the last one having the highest value.

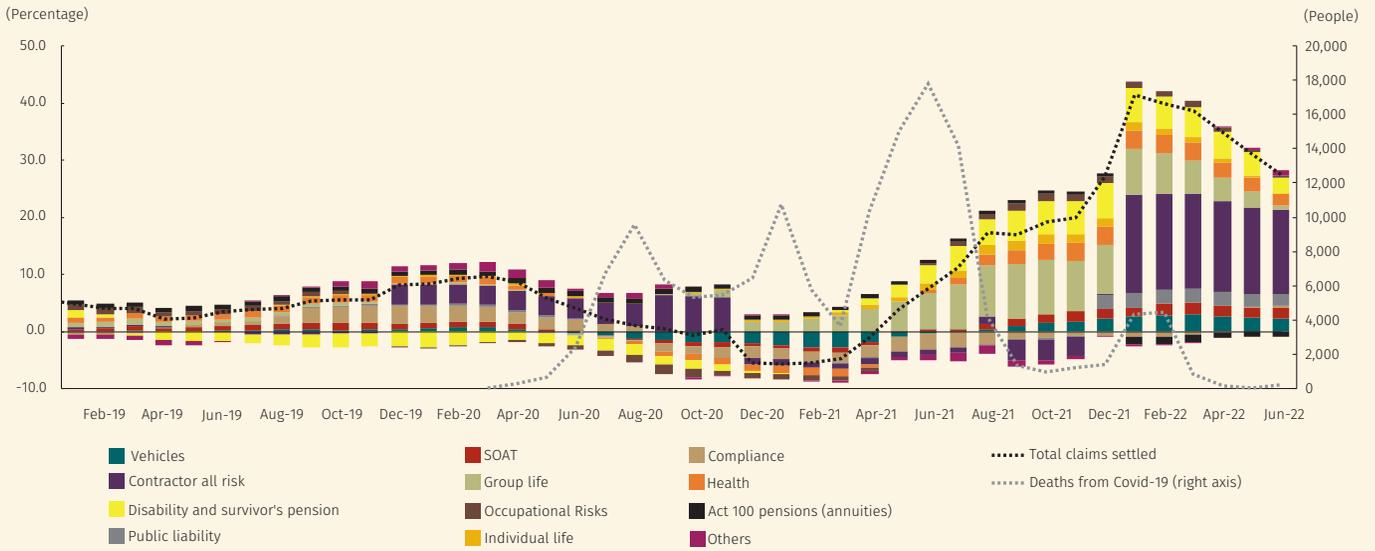
9 Insurance in this BL guarantees the fulfillment of obligations contained in the law or in a contract. For example, a lessee may purchase compliance insurance, and in the event that the lessee defaults on payment as stipulated in the lease, the insurer will pay the lessor compensation for the default.

10 According to Fasecolda figures, lease insurance contributed to the increase in the SC of the compliance BL during the pandemic. Specifically, as of October 2021, at least COP 200 thousand million had been paid to support the payment of rental obligations for housing and commercial properties.

11 This information is not available for the pandemic period given that disaggregated data for the compliance BL had not been reported until February 2022 on the FSC Form 290.

12 The performance of Act 100 pension BL premia is due, in part, to structural aspects that existed prior to the pandemic and that have had an impact on the life annuities offered under this BL. See the study "Subasta del seguro previsional en Colombia", URF (Unidad de Regulación Financiera), May 2022.

Graph B1.1  
Contribution by BL to the Real Annual Growth of Annualized Settled Claims

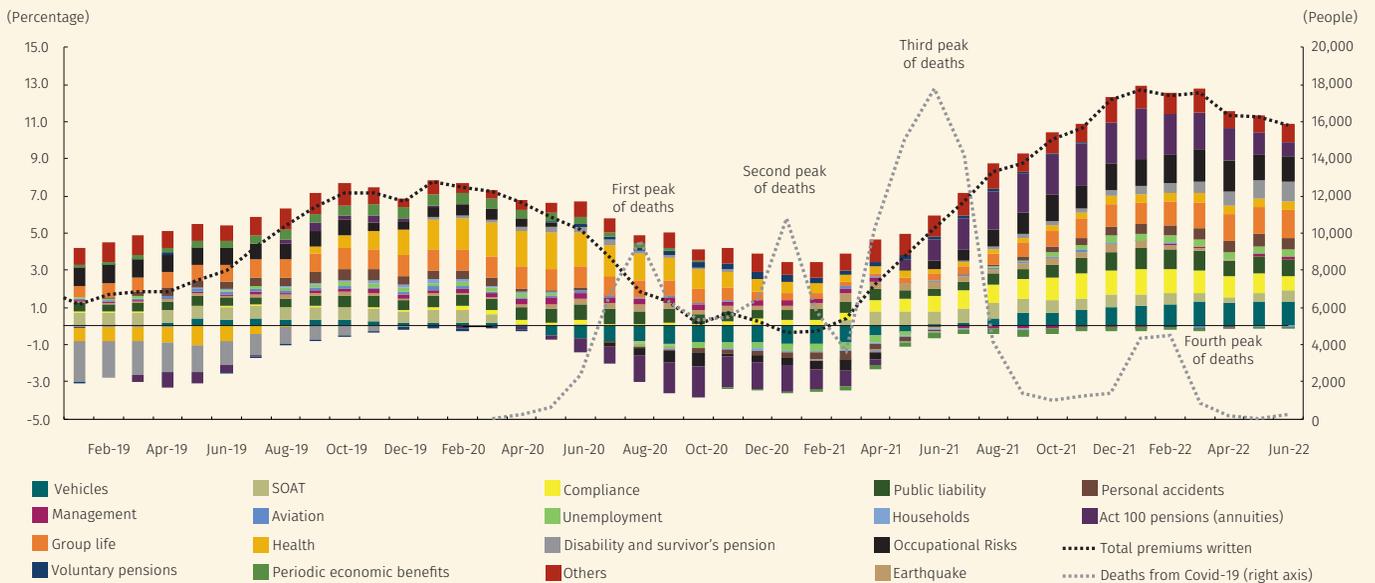


Notes:

- Public liability insurance covers the insured for indemnity expenses for damages to third parties (injury or death) or for property damage caused by the insured to the property of third parties.
- Occupational risk insurance is offered by occupational risk management companies and is responsible for insuring the working and productive population against occupational accidents.
- Under the BL of Act 100 (life annuities), individuals who have the capital to retire may choose the life annuity pension mode and thus authorize the PFM to transfer the balance accumulated in their individual savings account (ISA) so that the insurer will be responsible for paying the pension benefits for life. The payment of the premium (premium issue) occurs when the transfer of resources from the ISA to the insurer is generated. This payment is known as the single premium.
- The category "others" includes 21 categories, among which are the BLs: fire, theft, transportation, weak current, contractor all risk, loss of profit, machinery assembly and breakdown, navigation, glass, commercial credit, etc.

Source: Office of the Financial Superintendent of Colombia, calculations by Banco de la República.

Graph B1.2  
Contribution by BL to the Real Annual Growth of Annualized Premia Issued



Notes:

- Like the pension insurance under Act 100 (life annuity), voluntary pension insurance is paid with a single premium, but the insurer pays a monthly allowance for the period agreed upon with the insured (not life annuity).
- The Periodic Economic Benefits BL consists of transferring the resources to the Periodic Economic Benefits Program (BEPS in Spanish) when the retirement age is reached and the pension requirements are not met. Under BEPS insurance, insurers pay the value of the BEP on a bimonthly basis until the death of the insured.
- Management BL covers the insured for fraud, theft, forgery, etc. by its employees.
- The category "others" includes 21 categories, among which are BLs: fire, theft, transportation, weak current, contractor all risk, loss of profit, machinery assembly and breakdown, navigation, glass, commercial credit, etc.

Source: Office of the Financial Superintendent of Colombia, calculations by Banco de la República.

bility of carrying out certain medical procedures; 2) restrictions on automobile traffic, and 3) the increase in unemployment generated a reduction in the demand for occupational risk insurance. After the second peak of deaths when the lockdown measures were relaxed, these lines showed recoveries and there was an increase in premiums written for group life BL (Graph B1.2).

Given the lockdown measures, the risk for those insured was expected to decrease for other lines of general insurance such as, for example, public liability, transportation, machinery erection and breakdown, contractor all risk, and aviation. Therefore, the FSC issued External Circular 21/05 June 2020, which required insurance companies to establish internal policies and methodologies in order to: 1) identify the products for which there could be a decrease in the insured's risk as a result of the preventive isolation measures, and 2) quantify the decrease in risk and the corresponding reduction in the premium in order to reimburse it through the return of sums of money, the extension of insurance coverage, or any other contractually defined mechanism. Likewise, for the SOAT BL, Decree Act 800/2020 ordered insurers to transfer the funds equivalent to the lower value of the claims resulting from the reduction in the use of vehicles and traffic accidents to the Resources Administrator of the General System of Social Security in Health (ADRES in Spanish).

## 2. Loss ratios

Graph B1.3 shows gross and net loss ratios for the BLs that were most affected by the pandemic<sup>13</sup>. Gross loss ratio had increased starting at the beginning of the crisis for BLs of the life insurance group (panel A), especially for the pension disability and survivorship and group life BLs. With respect to the general insurance group (panel B), gross loss ratio rose during the first two peaks of the pandemic for the BL of unemployment and fell for vehicle and SOAT BLs. The claims and the loss ratio indicator, in turn, decreased for the BL of compliance and rose for the contractor all risk BL due to the impact generated by the *Hidroituango* case (Graph B1.3).

In terms of net loss ratio, a similar behavior was observed for most of the analyzed BLs. The exception was the contractor all risk line since the operation related to *Hidroituango* was reinsured (the net loss ratio deducts the amounts payable by the reinsurers). In addition, the difference found between the net and gross loss ratio for the vehicles BL is due to an increase in the build-up of claims reserves<sup>14</sup> for this BL.

## 3. Operational profitability

The above results had a negative effect on the operational profitability indicators of the insurance business. Graph B1.4 shows that since the beginning of the pandemic, all BL belonging to the group of life insurance (with the exception of the health BL) registered a drop in their technical and fiscal year results<sup>15</sup> and only began a slow recovery as of June 2021

$$^{13} \text{ gross loss ratio} = \frac{\text{claims settled}}{\text{premiums written}}$$

$$\text{net loss ratio} = \frac{\text{claims incurred}}{\text{premiums earned}}$$

$$\text{claims incurred} = \text{claims settled} - \text{reinsurance portion} + \text{claims reserves}$$

$$\text{premiums earned} = \text{premiums withheld} - \text{buildup of technical reserves (TR)} + \text{release of TR}$$

$$\text{premiums withheld} = \text{premiums written} + \text{premiums accepted} - \text{premiums ceded}$$

<sup>14</sup> Claims reserves (reported and not reported) are established to cover payments for claims that have occurred once they have been reported or for possible claims that have occurred but have not yet been reported.

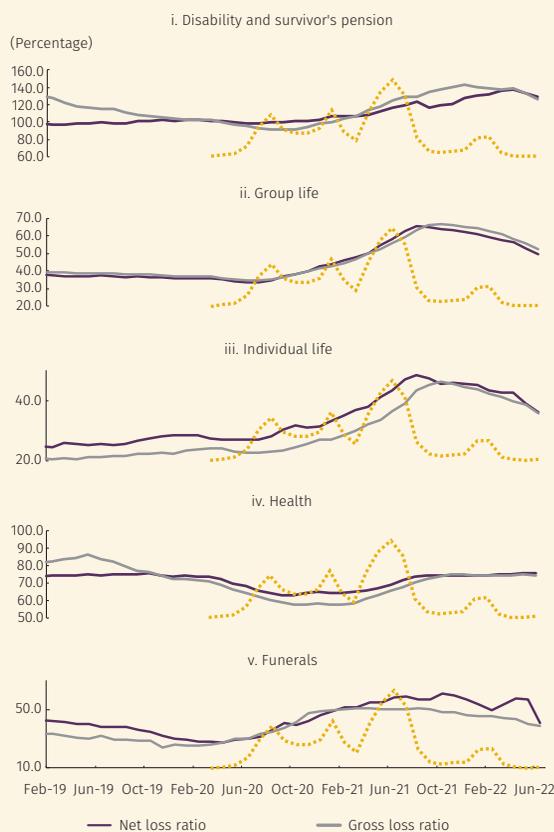
<sup>15</sup> The technical result and the fiscal year results inform about the insurer's operating income and are calculated as follows:

$$\text{technical result} = \text{insurance and reinsurance income} - \text{insurance and reinsurance expenses} - \text{commissions and overheads}$$

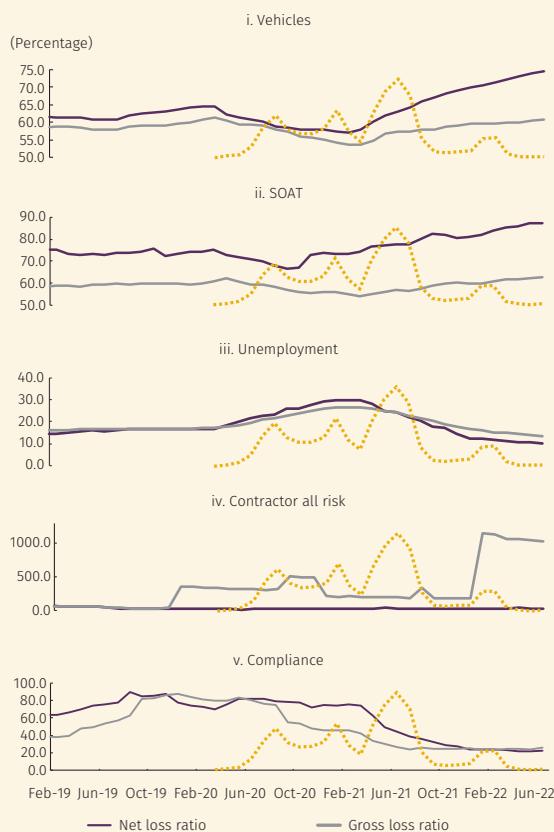
$$\text{fiscal year results} = \text{technical result} + \text{investment income} + \text{other income} - \text{other expenses}$$

Graph B1.3  
Gross and Net loss ratios by BL

A. Life Insurance Group



B. General Insurance Group



Notes:

- Annualized settled claims and annualized written premiums are used to calculate the gross loss ratio. Annualized incurred claims and annualized earned premiums are used to calculate the net loss ratio.
- The dotted line represents deaths from Covid-19. Each BL has its own scale.

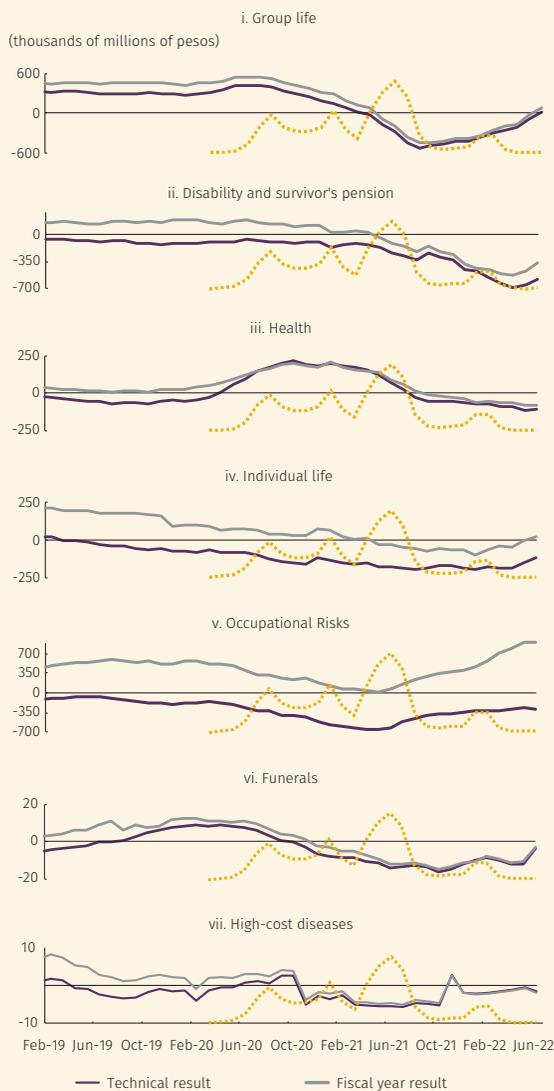
Source: Office of the Financial Superintendent of Colombia, calculations by Banco de la República.

(panel A). With regard to the BLs in the general insurance group (panel B), the technical and fiscal year results for vehicles and SOAT have shown a downward trend since the beginning of the pandemic. Although BLs of unemployment, commercial<sup>16</sup> and household credit fell in 2020, they began to recover after the largest peak of deaths, i.e., when vaccination plans were implemented, lockdown measures were reduced, and economic reactivation policies were introduced.

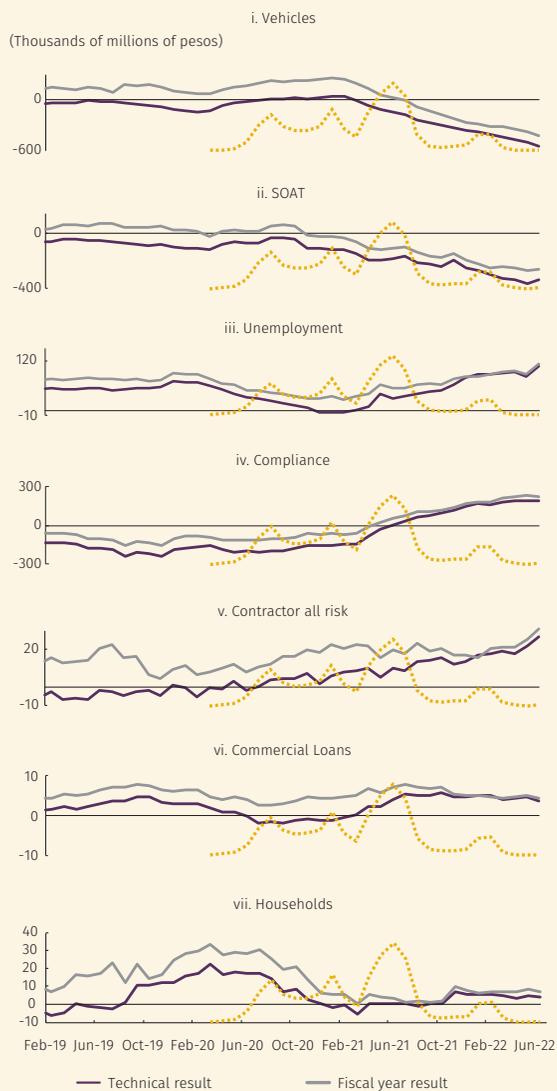
16 Credit insurance indemnifies businesspeople who sell their products on credit for non-payment of such credits.

Graph B1.4  
Annualized Technical and Fiscal Year Results by BL

A. Life Insurance Group



B. General Insurance Group



Note: the dotted line represents deaths from Covid-19. Each BL has its own scale.  
Source: Office of the Financial Superintendent of Colombia, calculations by Banco de la República.