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Dear Lauren,

Impact of COVID-19 on Hospitality Employers Mutual Limited

COVID-19 Claims

As of 27 January 2022, Hospitality has received 691 COVID-19 claims. Over December 2021 and January 2022 reported claims have increased by over 100% due to COVID-19 claims. The majority of these claims remain open at this time, so ultimate costs are not known but the average incurred cost (i.e. paid to date plus estimated outstanding liabilities) for these claims is $2,700, although this doesn't include any allowance for 'long COVID' or fatalities at this point.

COVID-19 case numbers in the community continue to be high and while it appears the current wave has peaked, further COVID-19 cases are expected to continue for some time yet. There is also a significant potential for further waves of cases.

The presumptive provisions of s.19B of the Workers Compensation act 1987 passed by Parliament in May 2021, have substantially exacerbated Hospitality's position as it essentially makes all proven COVID-19 claims compensable regardless of whether the virus was contracted in the workplace or not. Effectively transferring the cost of COVID-19 from the community and government to employers and their workers compensation insurers. Part of the impact could have been mitigated by the implementation of a Risk Equalisation Mechanism envisaged by s.19B, but SIRA and the Government have declined to implement such a mechanism.

While ultimate COVID-19 claims numbers remain highly uncertain, our internal modelling suggests that ultimate numbers of between 1,500 and 3,000 COVID-19 claims this financial year are likely. Assuming an average cost of $2,700 per claim this would result in an estimated direct COVID-19 claims costs of between $4.1 million and $8.1 million. We also note that SIRA's actuaries, Ernst and Young, have previously advised SIRA that Hospitality could face COVID-19 claims costs of between $15.2 million and $20.2 million.

Any of these outcomes would be sufficient to generate a material loss in 2021/22 financial year, place significant pressure on Hospitality's capital position and, at the high end of the range, its long term viability.

Operational COVID-19 Impacts

To date Hospitality have spent over half a million dollars in additional operational expenses to manage the significant influx of COVID-19 claims effectively and continue to provide the high level of service that we are known for. We have enhanced our technology to support efficient processing of COVID-19 claims and increased our claims staffing by 19%.

We are proud that we had forecast the substantial increase in claims reported and prepared accordingly thus limiting the impact on claims unrelated to COVID-19 and our policyholders. However, it is inevitable that with an increase of over 100% in reported claims there is a diversion of effort that will negatively affect service levels and return to work outcomes for all claims.

Other COVID-19 Impacts

In addition to the direct effect of COVID-19 claims, there has been a range of adverse impact from COVID-19 and COVID-19 lockdowns, these include:

- Reduced availability of suitable duties and return to work opportunities during lockdowns and period of reduced operations
- Limitations on access or reduced access to treatment
- Reduced premium income because of lockdowns or reluctance in community to expose themselves

The combined effect is longer claim durations with increased claim costs and reduced premium income. This places further pressure on Hospitality's financial and capital position.

Impacts on Reinsurers

Hospitality relies on the support of reinsurers to limit its capital exposures and reduce the amount of capital required to meet APRA's Capital Adequacy standards. Without reinsurer support Hospitality could not continue to operate.

In the face of COVID-19 related losses, reinsurers may decide to:

- Cease support for Hospitality
- Exclude COVID-19 losses from coverage
- Substantially increase reinsurance costs

Should either of the first two points occur it is doubtful that Hospitality would have sufficient capital to continue to operate without a substantial capital injection.

Capital Impacts

As required by SIRA policy, Hospitality is an insurer licensed by APRA and is required to meet APRA capital standards. Hospitality is required to maintain a Capital Adequacy Multiple (CAM) of 1.5 (the multiple of available capital to the Prescribe Capital Amount under APRA regulations).

Direct COVID-19 claim costs together with the indirect COVID-19 impacts and the potential reinsurer responses if at the severe end of the range would lead to its CAM falling below its 1.5 minimum. Should Hospitality's CAM fall below 1.5, or be expected to fall below 1.5, Hospitality would be required to implement capital remediation strategies to return its CAM above 1.5. Options to consider could include (all subject to ongoing viability of the business):

- Obtain additional capital from shareholders
- Obtain additional capital support from reinsurers (unlikely in the context)
- Increase premiums (discussed further below).

If Hospitality doesn't have a sustainable and profitable option for moving forward and addressing its capital position, the remaining option open to it will be to cease underwriting and to go into run-off.

Premium Impacts

As outlined above, during 2021/22 there have been material direct and indirect impacts from COVID-19 on Hospitality's financial and capital position leading to losses in 2021/22 and reductions in capital adequacy. While it is clearly uncertain, and we will be seeking external actuarial advice on this question, it appears likely that there will be continuing COVID-19 financial impacts in 2022/23. These will be exacerbated if the presumptive provisions of s.19B remain in force (and SIRA continues to decline to implement an effective Risk Equalisation Mechanism under s.19B).

This means in order for Hospitality to meet its prudent obligations, and to provide comfort to its reinsurers that it will be underwriting profitably, Hospitality will need to increase premiums. Hospitality will be taking independent actuarial advice on the required rates to cover estimated costs and this will form the basis of our 2022/23 premium filing.

However, any material premium increases will also create competitive issues for Hospitality – which are discussed below.

Competitive Neutrality with the Nominal Insurer (icare)

Hospitality is an APRA regulated insurer and is required to maintain a level of capital above APRA's minimum Prescribed Capital Amount. The Nominal Insurer is Hospitality's sole competitor, however, the Nominal Insurer is not regulated by APRA. Since 2015 when icare was established the Nominal Insurer has accumulated losses of over $4 billion and now has at 30 June 2021 a deficit of $253 million i.e., negative equity of $253 million. If the Nominal Insurer were an APRA regulated insurer it would require significant capital injection in order to continue to operate.

Despite these losses, the Nominal Insurer continues to file premiums (and SIRA continues to allow premiums) that are materially below the actuarially assessed break even premium rate so losses can be expected to continue, and the deficit will continue to grow.

icare have stated that they do not intend to pass on additional COVID-19 claims costs to employers insured with the Nominal Insurer. Ultimately these costs will add to the expected losses, growing the deficit and left for future generations of employers to fund. The fact that the Nominal Insurer can operate in such circumstances, places Hospitality at a massive disadvantage.

Hospitality is faced with invidious choice of raising premiums to cover expected cost increases, thereby making it uncompetitive with the Nominal Insurer's under-priced premiums, risking the loss of substantial business to the Nominal Insurer. With substantial loss of business to the Nominal Insurer, Hospitality loses economies of scale and becomes less viable and potentially ultimately unviable.

Alternatively, if Hospitality seeks to maintain premiums that are competitive with the Nominal Insurer it risks further losses and erosion of its capital position, APRA regulatory action and the loss of support from reinsurers. This is also not a sustainable option for Hospitality.

Hospitality is on the horns of a dilemma not of its own making but brought on by COVID-19, exacerbated by the presumptive provisions of s.19B and SIRA's refusal to implement the Risk Equalisation Mechanism and by the Nominal Insurer's decision to systematically set premiums below the breakeven rate (with SIRA approval) and not pass on COVID-19 costs.

s.19B must be repealed or an effective Risk Equalisation Mechanism be implemented urgently.

Regards,

Angus McCullagh
Chief Executive Officer
Hospitality Employers Mutual