What a racquet!

My daughter was born on the last Sunday of June 2007. Wimbledon started the next day; I was on parental leave. For the better part of two full weeks, my baby girl slept on my chest while I watched the event play out.

If only for this reason, the annual celebration of tennis held in southwest London will always occupy a special place in my heart.

Fast forward 13 years, and instead of sleeping on my chest, my young teenager is now a keen tennis player herself and regularly beats me at the game.

In an alternative reality, both of us would have been looking forward to watching the opening match of the world's pre-eminent grass court tournament next Monday.

The bad news, of course, is that Wimbledon has been cancelled due to Covid-19. The good news, thankfully, is that the All England Lawn Tennis Club will not suffer much financial damage in the process.

This is due to it coughing up no less than $34m for pandemic insurance over the past 17 years, leading to a payout reported to be $141m this year.

But not all businesses have been equally lucky (or prescient, as the case may be): in SA, for example, more than 400 operators in the tourism and hospitality sector alone are in dispute with their insurers.

All these claimants reportedly had business interruption policies in place; to add insult to injury, they apparently also had a policy extension which specified interruption by an infectious or contagious notifiable disease.

Insurers are refusing to pay, on a technical point: their position is that losses have been caused by lockdown measures imposed by the government, not by the coronavirus itself (which is clearly a contagious notifiable disease).

Evidently, there will have had to be a proven case of the virus on the premises in question before pay-outs would be triggered.

While one cannot really blame insurance companies for vigorously defending claims based on carefully articulated legal language in policy documents, there are those who now refer to the whole industry as a disgusting racket. Compromise is still possible, but it seems likely that large-scale litigation will follow.

Something similar is playing out on a global stage.

Arch Capital Group Ltd (ACGL), for example, is the world's largest mortgage insurer and has a focus on speciality lines (the segment of the industry where some of the more unusual risks are underwritten).

In February this year, ACGL traded on the Nasdaq at a record high share price of about $48. In the five weeks that followed, it lost more than half its value as investors grew fearful that the company would be forced to pay out on business interruption policies that were never priced to cover a risk such as Covid-19.

From a recent low of just over $22, the share price has, however, started to recover slowly and is trading just above the $30 level at the time of writing — still about 35% lower than the lofty pre-lockdown levels.

In the US, insurance coverage is more uniform than in SA and elsewhere, with many of the policies taken out by small and medium-sized businesses being based on standardised language on ISO forms (the acronym stands for Insurance Services Office).

If it is ruled that Covid-19 is in fact covered by one of these policies, the risk will therefore essentially be covered for anyone who has taken out a similar policy. It also means that the US insurance industry stands more united than those in other parts of the world in defending themselves against claims of this nature.

The main challenge for US policyholders is that ISO forms typically require the property itself to be damaged in order to trigger any business interruption pay-out; it is debatable whether Covid-19 would qualify in this regard.

As is the case in SA, claimants are up in arms. Once again, litigation lawyers may end up being the biggest winners.

Regardless of what the courts eventually decide, however, insurance premiums tend to go up after periods of catastrophic losses.

In addition, events for which companies were previously estimating potential losses are now also more quantifiable, allowing them to more accurately price such risk.

Both these points are clear positives from the perspective of insurers.

Against this background, there's every chance that the market has over-reacted in terms of the insurance sector sell-off, with declines in market capitalisation far exceeding the expected amounts that companies are likely to pay out when all is said and done.

I had planned to buy my daughter a new tennis racquet for her birthday this week. But perhaps I should rather buy into a racket of a different kind and add some ACGL shares to her portfolio. x

Gouws is chief investment officer at Credo Wealth, London

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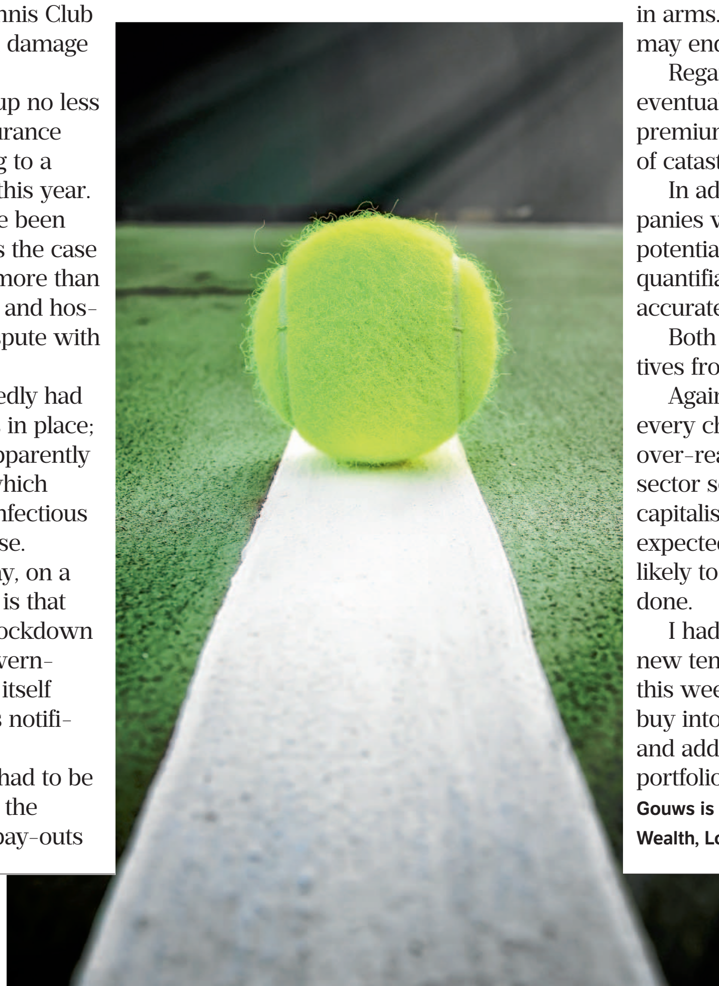

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