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Research note

COVID-19 and the public perception of travel insurance

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Introduction

Before the COVID-19 pandemic, travellers were predominantly under- or uninsured for their travel (Quantum Market Research, 2017, 2018; Sarmon et al., 2020). This problem will likely be exacerbated when international travel resumes. Sarmon et al. (2020) report that only 12.8% of US-based travellers usually purchase travel insurance. A range of factors may explain traveller underinsurance, including risk framing, perceived immunity due to destination familiarity, and travellers' (mis)understanding of risks at the destination (Caponecchia & Tan, 2019). In this research note, we highlight the effects of reverse moral hazard resulting from the COVID-19 pandemic, and how stakeholders will have to devise new strategies to address this issue.

Travel insurance claims and the COVID-19 pandemic

Early in the pandemic, many travel insurance claims were being denied due to the operation of pandemic and/or known event exclusions. Data presented to the House of Representatives Standing Committee on Economics indicates that in April 2020 one large travel insurer received 10,000 claims, most of which would be denied due to pandemic or known event exclusions (Commonwealth of Australia, 2020). Some insurers and travel companies decided to refund the unused portion of a travel insurance policy (e.g. if the travel was to occur after the pandemic was declared). However, for those who experienced travel losses due to the pandemic, travel insurance was not useful in the very circumstances in which it was most needed.

Problems in communicating, using, and understanding the exclusions and conditions of insurance products are well known (Cude, 2005; Insurance Council of Australia, 2015; Quantum Market Research, 2017). Notwithstanding these issues, the unavailability of travel insurance when it is most needed could significantly influence the uptake of travel insurance into the future through a reverse moral hazard effect. The reverse moral hazard effect has been cited in the medical insurance literature as the driver for reductions in household medical care utilisation and expenditure as a result of less generous insurance cover

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(Abraham et al., 2010; Choi & Liang, 2007). Similarly, we posit that recent events due to COVID-19 will reduce the perceived coverage and value of travel insurance, and in turn, result in a greater reluctance to travel in general and particularly towards destinations that are deemed riskier.

Pandemics differ in insurability from natural disasters due to the scale of losses and difficulty in diversifying risks. These issues are also faced by reinsurers and thus make pandemics a difficult risk to insure (Finity Consulting, 2020). Similarly, recent insurance experiences during COVID-19 may reduce the perceived coverage of travel insurance, and lead travellers to seek alternative risk mitigation strategies. This is a consequence of two widespread phenomena: the experience of a pandemic combined with poor product understanding.

Individuals have previously experienced losses while being insured (e.g. finding that their insurance did not cover loss of luggage within 12 h), but these are isolated experiences and do not gain significant public attention. That a vast number of travellers have experienced losses at the same time highlights issues of clarity, usability and appropriateness of exclusion clauses and other conditions. Accordingly, pandemic and known event exclusions, due to their wide application, can shift perceptions of the value of travel insurance and cause a reverse moral hazard problem in the market. That is, the perceived reduction in travel insurance coverage will affect traveller decisions and expenditure patterns.

Value in travel insurance

The value proposition of insurance to travellers is the ability to significantly reduce risk exposure during travel. Travel insurance policies typically cover only idiosyncratic (insurable) risk events (Doherty & Dionne, 1993). Idiosyncratic events such as theft or lost property are attributable to personal traveller circumstances and are diversifiable by the insurer. It is reasonable for the insurer to assume these risk events, across travellers, are independent and – when aggregated – are relatively low risk (Markowitz, 1952).

By contrast, catastrophic risk events such as pandemics are highly correlated across policyholders and have losses that are excessive in scale. These are effectively excluded in almost all insurance policies as they are difficult to diversify (Doherty & Dionne, 1993), resulting in little to no risk-reduction when bundled into a portfolio (Markowitz, 1952). The exclusion of certain catastrophic risk events is required to ensure insurers remain solvent (Finity Consulting, 2020), though this may be a new realisation for misinformed policyholders.

For those individuals who don't read or understand disclosure statements – a sizeable percentage of travellers (Insurance Council of Australia, 2015) – this will likely cause a downwards revision of the perceived value proposition of travel insurance products that mitigate only idiosyncratic risks. This will exacerbate the underinsurance and non-insurance problem through a reverse moral hazard effect, where consumers alter their behaviour when a perceived *reduction* in risk transfer occurs. That is, given the perception of less risk coverage from insurance policies, travellers may compensate with overly conservative behaviours and choices. These choices can have wide-ranging economic effects.

Effects of increased traveller underinsurance

Arguably there has been reputational damage to the concept of travel insurance during the COVID-19 travel restrictions, as many customers were left out-of-pocket despite their perceived coverage of risks. For example, RoomerFlex avoided paying out their policies despite the absence of pandemic or known-event exclusions (Tims, 2020). Instead, they have refunded their customers' premiums, which is analogous to a winning lottery ticketholder being refunded the cost of the ticket instead of receiving their rightful jackpot.

Reverse moral hazard could result in reduced travel to particular destinations and impact tourism operators, local economies, airlines and travel insurers. Some people will be less likely to travel at all. Recent research indicates that 35% of Australians reported reduced likelihood to travel internationally after the virus is contained (Kassam, 2020). Destination choice could be altered due to the current environment and the (new) knowledge that catastrophic travel risks are not covered by insurance policies. The corollary is that a destination's natural state of risk, or ability to handle risk events, will now be more important. Travellers unable to insure for prominent risk events, such as flight cancellations due to an unchecked health crisis, may choose alternate destinations. This is consistent with the personal risk management literature where strategies include risk reduction, transfer, avoidance, financing, and retention (Vaughan & Vaughan, 2014). It is possible that travellers may seek insurance coverage for pandemics, though policies that cover such events are not widely available (Finity Consulting, 2020).

Perceived risks related to health and safety, return journeys and repatriation in the context of the pandemic will add further complexity to how people view and value travel insurance. This will vary with trip purpose, education and income (Rittichainuwat et al., 2018; Roehl & Fesenmaier, 1992) and portability of existing health insurance, as well as beliefs about the pandemic (Akesson et al., 2020; Czeisler et al., 2020). In addition, there will likely be particular effects for older travellers, those with existing medical conditions, people with disability, and those with loved ones who fall into these categories.

Governments will also have an enhanced vested interest in ensuring travellers are appropriately insured. Home countries will likely try to minimise the expectation of repatriation and costs of consular assistance, especially when research indicates that significant number of tourists misperceive how much assistance their government can provide (Quantum Market Research, 2018).

Conclusion

Moving forward, travellers will have to closely study the exclusions of their policies and be prepared for catastrophic risk events that may leave them stranded and/or with out-of-pocket expenses. This may influence the selection of destinations based on perceived safety of local conditions. Insurers will have to enhance communication with consumers to better articulate the benefits and coverage of their products, and we suggest an aggressive marketing and communication campaign to regain the confidence of travellers. The importance of traveller perceptions of safety in destination choice will likely begin to be emphasised by Governments and destination marketing organisations, as they market themselves as low-risk destinations (Cavlek, 2002; Seabra et al., 2013). When international travel resumes, the role of travel insurance will be more important than ever, along with further research on effective communication by insurers to consumers regarding product coverage, value and risk.

Declaration of competing interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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