COVID-19 AND BUSINESS OUTLOOK FOR INSURERS

IFIGS Webinar – "Business Unusual: Normal, Disrupted"

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Global Impact of Covid 19

- The rapid spread of the virus threatened to overwhelm the number of hospital beds available for treating Covid 19 patients, resulting in deaths that could have been avoided.
- Many Covid 19 deaths are not reported as such, thus understating the actual mortality rate.
- Long term impact on the health of those who recovered from the virus is uncertain.
- The government imposed lockdown on the economy has resulted in:
    - Working population facing financial strain from loss of income as a result of job losses
    - Business owners face meeting unwavering fixed cost & are at risk of bankruptcy
    - Some industries are more badly hit than others
        - Tourism & Travel – Airlines, Hoteliers
- Aggressive actions by central banks to support valuation of financial assets
- Aggressive government programs to support the “main street” economy
- OECD projecting heavy reduction in GDP growth for most countries

Global Impact of Covid 19

The New Normal

It is to be expected that beyond the short term market volatility evidenced in the drop of equity indices, widening credit spread, the pandemic is expected to radically change global outlook in terms of economic growth and customers' behaviour.

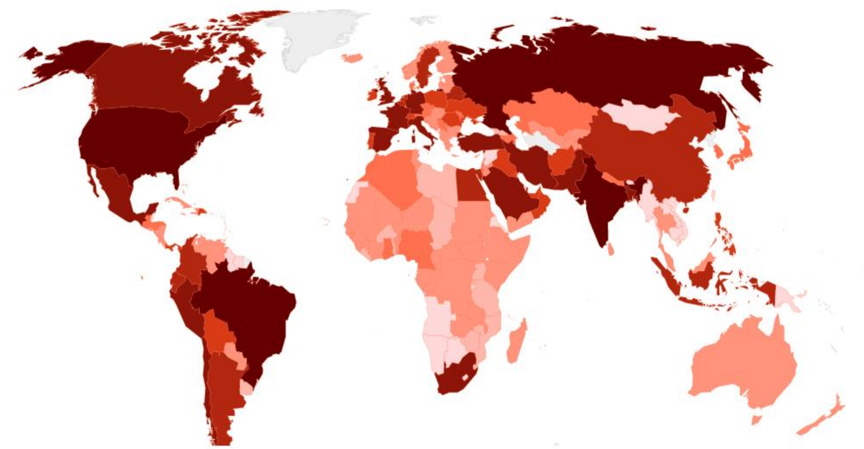
Life insurers protect lives and savings while Non-Life insurers protect assets of individuals and businesses.

How would insurers fare in this New Normal?

Confirmed cases of COVID-19

As of June 28, 11pm EDT

Confirmed cases	Deaths	Recoveries
10,145,791	501,893	5,140,899
+166,256 from yesterday	+3,183	+89,035



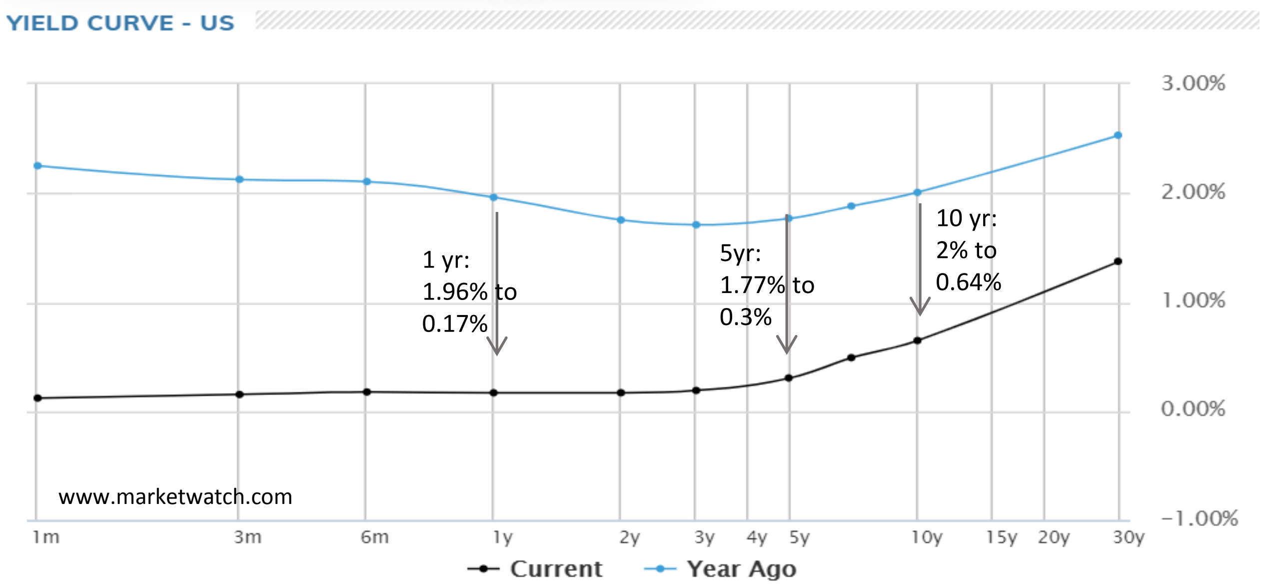
Top countries by confirmed case count

1. U.S.	2.55m	6. Peru	279k	11. Mexico	216k
2. Brazil	1.34m	7. Chile	271k	12. Pakistan	206k
3. Russia	633k	8. Spain	248k	13. France	199k
4. India	548k	9. Italy	240k	14. Turkey	197k
5. U.K.	312k	10. Iran	222k	15. Germany	194k

Data: The Center for Systems Science and Engineering at Johns Hopkins; Map: Axios Visuals

Rise Of Reverse Margins For Insurers

- Economic stimulus measures by central banks will involve lowering interest rates



- Reverse margins occurs when there is a shortfall between investment income earned by insurers and the higher guaranteed returns they are required to pay policyholders.
  - Korea: an estimated 40% of life insurance portfolios comprise of policies guaranteeing returns of over 5% p.a.
  - Malaysia: Legacy products priced at higher yields. Surrender values on non participating products have implicit underlying guarantee of 4%
- In theory insurers in RBC environment are well capitalised but are exposed to default risks:
  - Adequate technical provisions to meet prospective liabilities as valued on risk free rate. Additional capital to support deviation in experience
  - Investment allocation: ALM meant insurers now are better matched with higher fixed income allocation (less equities) – but are exposed to downgrades and defaults

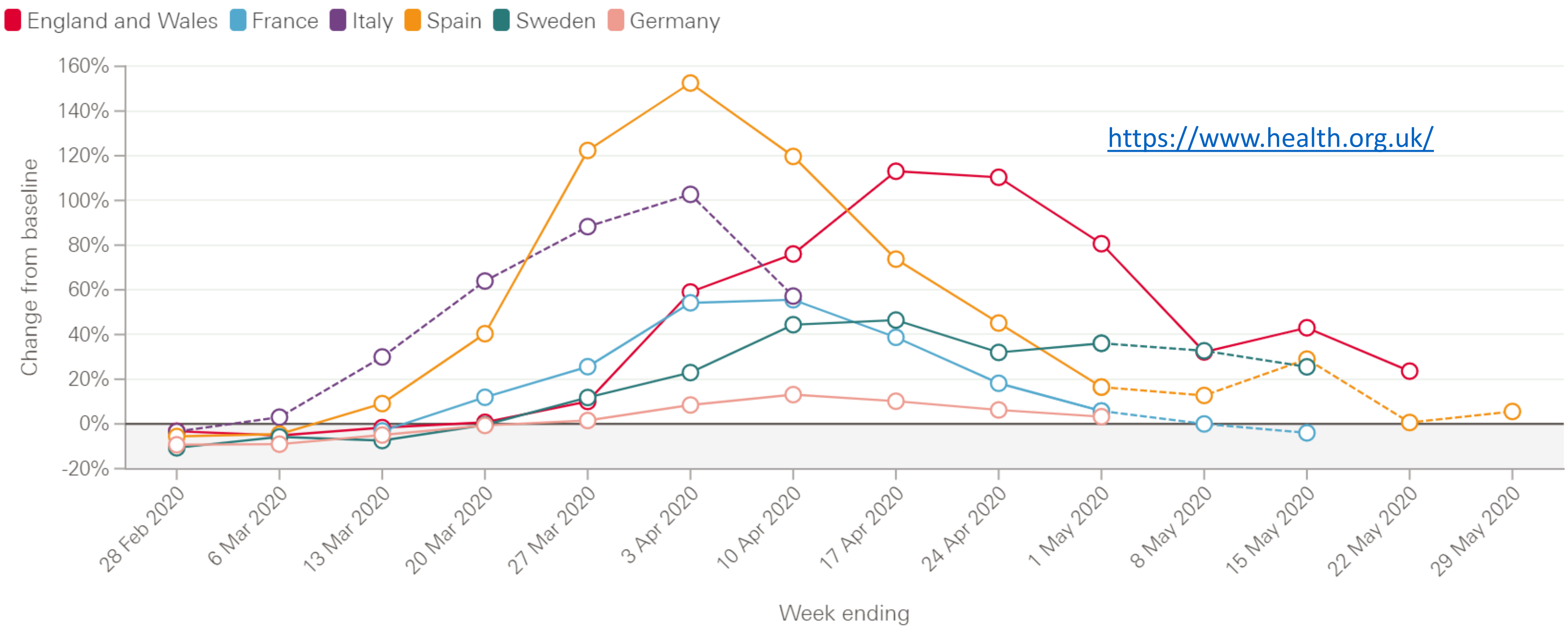
Uncertainty around the Mortality and Morbidity Experience

- Case fatality influenced by
  - Age
  - Underlying co-morbidity
  - Socio economic background
  - Obesity (new risk factor)

- Hasten demise of impaired lives OR increase in future mortality rates?
- Temporary Volatility or Long Term Effect?
- Survivors of the infection at worse risk due to compromised respiratory system?
- Population to enjoy a higher life expectancy due to better future response to pandemics

Uncertainty around the Mortality and Morbidity Experience

Tracking Excess death



- The observed recent apparent excess mortality is unlikely to be due to typical annual volatility

Uncertainty around the Mortality and Morbidity Experience

Tracking Excess death

Government Moratorium and legal challenges

Examples

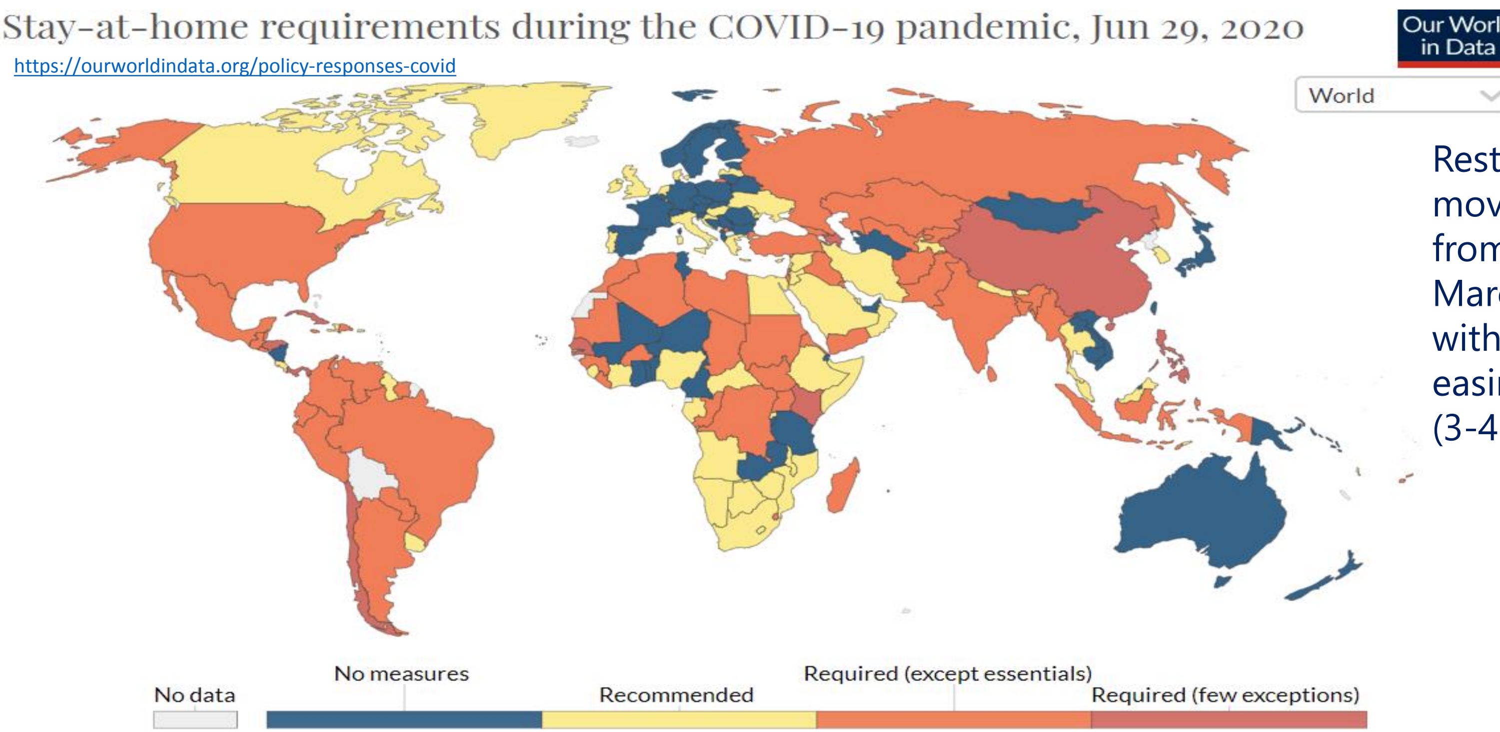
1. Australia: banks allow deferral of home loan repayments for up to six months
2. Malaysia: deferring loan repayment on mortgage, car hire-purchase, may also defer insurance premiums
   - For credit loans, banks can charge cumulative interest & add amount to outstanding loan balance.
   - Are insurers expected to continue additional coverage at no cost?
3. UK: Insolvency law reforms
   - Allow Companies a breathing space, but does not let them off the hook altogether – for e.g. rent will still be payable and with accrued interest.

Note IMF has a policy tracker summarizes the key economic responses governments are taking to limit the human and economic impact of the COVID-19 pandemic. The tracker includes 196 economies. https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#U

Is moratorium just deferring eventual defaults?

- "Exclusions" may protect insurers from paying out, but insurers are expected by governments to step up as a cornerstone of financial stability.
- US: Dispute over Business interruption (BI) claims

Insurers' Challenging Business Outlook



Restriction in movements from mid March 2020 with some easing recently (3-4 months)

- Lower Sales Volume in 2020
  - Credit Protection (no Mortgage business)
  - Motor insurance (no sales)
  - Restricted Face to Face Sales due to Social distancing rules
- Poorer Persistency in 2020 & beyond
  - Unaffordability to continue
  - Non-renewal of Motor Insurance
  - Investment linked products and Sustainability concern

New Normal: Taking advantage of change in policyholders' behavior

- Pockets of upsides
  - Higher use of Technology by consumers (working from home, online shopping etc.)
  - Increased insurance awareness.
  - Improvement in volume and in persistency on health & term plans (protection cover).

- Engagement
  - Changes in the customer engagement process, can insurers move away from face to face sales process?
  - Technology driven solution – straight through automation of underwriting process?

We are not out of the woods yet – "Clear and Present Danger"

- Will we see a second wave of Covid 19?
  - Experience evolving in China seems to imply that a recurrence of the pandemic is very likely. How governments react the second time around will determine how bad the second round will be.
  - How fast can we find a vaccine and how realistic is it to immunize the world's population
  - Are there any other pandemics lurking around the corner (swine flu?)

- Is there really a "free market" out there anymore?
  - Central banks aggressive interest rate cuts and bond purchases raises the question whether market dynamics have changed for good.
  - Citi Strategists are quoted as saying that "Day traders have driven stock-market euphoria to an 18-year high, boosting the odds of a downturn in the next year to over 70%".

Summary of impact on Life and Non-Life Insurers

- Life Insurers
  - In countries where the insurance penetration rates are low, life insurance penetration would be even lower and the impact of higher death claims is unlikely to be apparent to the insurers financial results. This is partly due to the observation that the hike in mortality is primarily seen in the elderly group, those with co morbidities and the low income group all of which are less likely to have life insurance.
  - Where sales are agency face-to-face driven, a reduction in new business will be apparent. The impact will be felt more by new insurers which do not already have significant renewal business
  - Impact on Balance Sheet will depend on the accounting and Solvency basis in place. Solvency basis determines valuation methodology and basis used and how capital adequacy is determined.
- General Insurers
  - Issues surfacing revolves around whether pandemic exclusions are enforceable. In particular for Business Interruption and Travel Insurance.
  - Lower claims may be expected from motor/automobile class of business and medical insurance, the latter because Covid cases are dealt with by the government and the public's reluctance to visit hospitals during the pandemic resulting in lower hospital admissions (for non-emergency elective cases).
  - General insurers are more likely to have liquidity issues should claims require the liquidation of assets when financial assets are depressed.
  - Impact on Balance Sheet is dependent on the its asset allocation strategy, its investments in bonds, loans, equities, properties and others. All asset classes are in one way or another affected by the pandemic. Some temporarily others perhaps permanent.

Managing insurers solvency position

- Jurisdictions which have already implemented Solvency II type Risk Based Capital
  - With the introduction of risk based capital it is likely that capital intensive life insurance products with guarantees have slowly been phased out by the industry. Issue of legacy products remain though. Thus solvency issues may have been exacerbated by the even lower risk free discount rates used to value technical liabilities.
  - Similar to the impact of risk based capital on new life insurance products, it is likely that the industry would have moved away from equity type investments to fixed income type investments. The impact of lower risk free rates on these investments depends on duration and credit spreads.
  - Question that can arise is how should the regulator respond to reduced Capital Adequacy Ratios arising from the Covid 19 pandemic? Are there countercyclical measures inbuilt into the RBC regime?
- Jurisdictions which have yet to adopt Risk Based Capital
  - Likely no change in the technical reserves calculations but big impact on the asset side of the balance sheet.
  - Other than the immediate impact in solvency (driven by the reduction in market value of assets) there is the potential of creeping insolvency which needs the regulators immediate attention:
    - Liquidity Risks
    - Credit Risks
    - Interest rate risks
  - Regulators need to ensure existing and new products which are still on the market are resilient in the New Normal

Conclusion

- Remains to be seen if the damage to insurers' balance sheet is temporary or permanent. If the latter there may be a flurry of Mergers and Acquisitions when the event passes. As it is still unclear when a vaccine is expected, the full impact of this pandemic is as yet unknown.
- There is likely to be a change in the consumers behavior. In particular how businesses are conducted. For insurance, more online sales and underwriting.
- For insurers there will be demand from consumer to relook at the exclusion clauses currently applicable. Can private insurers take on pandemic risks? Should such risks be carried by governments instead, like terrorist and radioactive risks? Alternatively can governments provide a "backstop" so insurance premiums can be affordable.
- Impact on insurers solvency position is unclear as the pandemic has yet to run its course. Initial signs of trouble will emerge when insurers find that they need to sell assets in order to meet their cash requirements (i.e. pay claims and expenses).
- Finally, are Insurance Protection Schemes able to manage situations of mass insolvencies resulting from a single event?