

POSITION PAPER ON COVID-19

MAY 2020

Introduction

COVID-19 is a global pandemic which is believed to have originated in China but has now spread worldwide. At the time of writing, there were 4.2 million diagnosed cases worldwide with more than 280,000 deaths associated with the illness. The epicentre of the virus has spread beyond China, firstly into Europe via Italy, with most European countries significantly impacted, but particularly Italy, Spain, UK and France. The US is now the epicentre, with almost 1.4 million cases and 80,000 deaths. Deaths from COVID-19 are particularly prevalent with persons showing certain pre-existing medical conditions and at older ages, with the average age of those dying being circa 80.

Responses across the globe have been unprecedented with large proportions of the world's population in lockdown. To various extents, people are confined to their homes with all other than essential travel banned. People who have been infected are in isolation where possible and contact tracing has been active in identifying and communicating with those with whom infected people have been in contact. There have been positive indications arising from measures taken, with the rate of growth of infections decreasing in many countries, and definite signs of flattening of death and infection curves. China has now substantially reduced lockdowns, with new infections having almost disappeared. Some European countries have also moved to reduce restrictions, while there is a range of measures in place in the US.

The next challenge will be reopening society at the right time in a way which will enable people to reengage with normal activity while ensuring that the conditions are right to minimise the risk of further outbreaks of infection and to ultimately eradicate the virus. Reopening is likely to be gradual, and the timing of widespread availability of an effective vaccine is likely to be key to resumption of full societal interactions.

There have been dramatic effects on economies worldwide resulting from the enforced changes in behaviour. China's economy fell in Q1 (by 6.8%). The Chinese government only began reporting quarterly economic growth estimates in 1992 but the last time it officially acknowledged a year-on-year fall in output was for 1976. Almost all economies are now in recession. Examples of impacts are a significant drop in oil price, dramatic increases in numbers unemployed globally, and heightened levels of business failure. Governments and central banks have responded by creating enormous fiscal and monetary stimulus to seek to maintain economies pending restoration of more normal levels of activity.

Investment markets have also been very significantly impacted, with European equity markets down 25% (EuroStoxx 50) year to date at 4 May, and global equity markets, having been as much as 30% lower in mid March before the recent recovery, down 13% (MSCI World). Interest rates have reduced

in main markets, though both sovereign and corporate bond spreads have increased, the latter to a much greater extent.

In summary, the impact of COVID-19 across the world has been enormous and it will have significant long term social and financial implications for economies, governments, corporate entities and individuals.

Impacts on (re)insurance companies

COVID-19 puts stress on many key areas of exposure for insurers at once, e.g. lower and more volatile asset prices, lower interest rates, higher bond spreads and defaults, challenges in business retention, efficiency and operational risk. For non-life insurance in Europe, higher claims come from lines of business such as non-damage business interruption, travel, event cancellation and medical malpractice, while claims are reduced from individual lines such as motor and home. For life and health insurance, higher mortality arising from the virus as well as requirements for medical treatment will impact on claims arising from mortality, sickness and perhaps also disability. In the short term, reductions in visits to doctors and elective treatments is likely to lead to lower claims on health insurance. The resulting economic slowdown will also impact on new business for all lines.

It will be important for (re)insurers to have a developed picture of the actual and potential impact across the full range of affected areas and to understand the range of risks to which they are exposed and possible outcomes. The Own Risk and Solvency Assessment (ORSA) carried out by (re)insurers is an ideal tool to give insight to the impact of COVID-19. Where representative scenarios are available from previous ORSA exercises, this is a valuable reference. Alternatively, an ad hoc ORSA may be required to consider risks not previously addressed. Financial measures impacted will include capital coverage, profitability, liquidity and availability of dividends to shareholders.

At this point in time, (re)insurers need to consider the stresses impacting on a number of groups of stakeholders, including employees, customers and distributors such as brokers and tied agents. As well as financial and capital impacts, areas affected include customer and business growth, people and operations, and strategy and performance management. Underwriting and pricing practices will need to adapt to the new environment.

Customers will be affected by the response of insurers to requests for claim payments, particularly where there is doubt as to coverage provided by their policies. Customers will also in many cases struggle to pay premiums. The reaction of (re)insurers to these situations will act to shape the reputation of the industry. There is evidence of many initiatives across Europe to alleviate the burden on customers at this time.

The main immediate balance sheet impact on the insurance industry as a whole comes from the impact of Covid-19 on capital markets and hence on the asset side of (re)insurers' balance sheets. Risks on the liability side of the balance sheet might also be very large for (re)insurers which are heavily exposed to certain types of insurance most at risk of heightened claim experience during the crisis, e.g. event covers and non-damage business interruption.

Operational risks are heightened with additional stresses from heightened customer activity, employees working from home, concerns re cyber security, and disruption of asset markets all impacting.

The AAE supports the position of EIOPA and European regulators in being responsive to the crisis. Regulators have rescheduled required regulatory submissions, postponed non-urgent work, and have been open to implementation of tools which could mitigate risks and impact, e.g. extension of recovery periods. EIOPA is focused on the information provided to customers and has encouraged fair, explicit and flexible treatment of customers. In this context, EIOPA has suggested premium refunds for lines of business with significantly reduced exposure due to the crisis. Heightened levels of regulatory scrutiny are in operation, reflecting the pressures operating on companies.

EIOPA has also asked (re)insurers to suspend dividends and share buy backs, and to avoid bonuses for the time being.

Completion of the 2020 Solvency II review by EIOPA will now be delayed until the end of 2020, and the COVID-19 crisis may bring new perspectives to bear as part of that review. Given the wide-ranging impacts of COVID-19, these may include heightened focus on system-wide impacts across the whole financial system.

Actuaries in (re)insurance companies are providing inputs in important ways:

- Supporting firms to think about the needs of their customers, considering the public interest, and mindful of the reputation of the insurance industry and its practitioners
- Providing input and direction, through actuarial and risk management functions, to fulfilment of regulatory capital requirements and use of stress and scenario analysis to understand developments in the risks to which (re)insurers are subject
- Supporting the provision of updated projections of business development and of revised pricing, allowing for the impacts of COVID-19
- Coordinating provision of effective interpretation of information and presentation of statistics.

The AAE also identifies some considerations which regulatory authorities should assess:

- The impact on the Solvency II 2020 review, including
 - appropriateness of stress factors being applied to risk modules
 - whether Solvency II allows properly for a pandemic crisis
 - effectiveness of measures to impact pro-cyclical behaviour such as equity symmetric adjustment
- Impact on consumers, and the need for Insurance Guarantee Schemes
- Macroeconomic impact in the short to medium term, with likely depressing impact on interest rates which are already at very low levels
- To the extent that COVID-19 constitutes an extraordinary adverse situation, alterations which could be made to prescribed Solvency II scenarios to provide capital relief for (re)insurers where necessary.

Impact on pension schemes

Pension schemes have been materially impacted by the economic impact of the COVID-19 pandemic following recent falls in equity markets and bond yields.

Investment market impacts have put pressure on solvency of defined benefit schemes. In some cases, that is leading to difficulty in making payments to retirees. Market impacts will also lead to a reassessment of the appropriateness of funding plans.

Defined contribution (DC) funds are significantly reduced by asset falls with implications for the level of retirement benefits.

The economic difficulties associated with the crisis are leading to difficulties for employers in making payments, with implications for the strength of employer covenants. Some pension schemes are enabling employers to reduce contributions for a short period of 3-6 months, seeking to ensure that risk benefits can continue to be funded. In some countries, state support is being made available to help employers fund contributions on a temporary basis. Some DC schemes are allowing delayed take-up of capital at retirement in order to enable conversion of capital into an annuity at potentially more favourable rates in the future (this is consistent with a recommendation of EIOPA). Most schemes have taken operational measures in order to ensure uninterrupted payment of pensions to beneficiaries.

Actuaries working on pension matters are providing inputs in important ways:

- Providing input and direction to efforts to understand current and forecast impacts of the crisis, allowing for various different possible scenarios
- Supporting schemes in addressing the needs of their members
- Providing analysis and information to understand developments in the risks to which schemes are subject, e.g. calibrating new longevity scenarios

Wider impacts of COVID-19 and actuarial insights

Use of data related to COVID-19

There is currently limited statistical comparability between countries due to different methods used to measure rates of infection and death, as well as different approaches to testing, testing capacity and criteria applied for test eligibility. As a consequence, it is not yet possible to effectively assess the future development of COVID-19.

The AAE will continue to monitor publicly available material from sources such as the European Centre for Disease Prevention and Control and the World Health Organisation as well as from actuarial or other professional bodies, and will draw the attention of its members to available models and insights in order to support them in fully understanding the implications of COVID-19 and in defining risk scenarios for financial institutions. The AAE will also be available to provide support to interested parties in interpretation of statistics in order to enable correct conclusions to be made. This could include comparison of incidence in European countries according to relevant criteria, e.g. population density, age, gender, socio economic segment, etc.

Modelling

Research-based actuaries have joined in the push to model more effectively the epidemiological dynamics of COVID-19 and the factors which might influence its ongoing development, both to contribute to broader public policy debates around responses to the crisis and to assist in private planning.

Scope of insurance cover

Differences have arisen between insurer, customer and government/regulator views on outcomes which are covered by insurance. Emerging from these differences, it is necessary to consider whether

insurance cover is sufficient and how communications with customers can be better managed. Extensions in cover may be necessary in the future in order to deal effectively with extreme events and provide the supplementary cover needed in times of economic crisis. Collaboration between the public and the private sector, e.g. in public-private-partnerships, might be able to develop a combination of innovative reinsurance coverage, Catastrophe Bonds and pandemic pools to address the shortage of coverage. Further extensions of coverage will definitely require public backstops, as for other global risks with strong economic impact.

The AAE will be available to provide input to considerations around structuring of such cover extensions, including regulatory and capital implications of alternatives.

The AAE and COVID-19

Some of the areas where the AAE and individual actuaries are contributing during this crisis are listed above.

The AAE will be available to all of its Member Associations to ensure that insights to COVID-19 outcomes can be brought to bear across Europe. We are committed to acting as a hub to share information, set appropriate standards for actuarial practice and education, and collaborate with European institutions to foster positive outcomes for customers and other stakeholders. We will also consider the implications of the pandemic for future education requirements of actuaries, to ensure that actuaries remain fully equipped to support (re)insurance companies and pension schemes through all scenarios emerging.

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