What does the Covid crisis mean for insurance companies and their regulation?

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Lessons for the insurance sector from the Covid-19 pandemic

Without question, Covid-19 has been one of the most globally disruptive events of the century. Much more than just a health crisis, the pandemic has caused upset and uncertainty for people and businesses, resulting in a severe economic crisis and triggering extraordinary fiscal support measures and recovery initiatives at national and European level.

The insurance industry has not been immune. As with every other business, insurers have had to take steps to maintain business continuity and services to customers, while also ensuring the safety of employees. Through their own preparedness and supervisory measures taken place to alleviate regulatory burdens, the sector has, by and large, weathered the crisis well.

While the crisis is far from over, there are already some lessons that we can draw from the crisis.

The Covid-19 outbreak has severely affected macroeconomic and market conditions worldwide which, coupled with the persistent low interest rate environment, increases the likelihood of a 'low for long' scenario with adverse implications for the insurance sector. As a result, insurers are significantly challenged in terms of asset allocations, profitability, solvency and business model adaptation.

Measures designed to alleviate the impact on the economic activity are likely to contribute to the continuation of the low interest rate environment.

While European insurers were on average well capitalised at the end of 2019, ultra-low interest rates affect the sector through the balance sheet channel both on the assets and liabilities side, but also through the income channel. Considering that market yields are at very low levels, this might have an impact on insurers' profitability in the medium to long-term horizon.

Viewing the pandemic through the lens of Solvency II underscores the risk-based nature of the framework and how, overall, the regime works well, even considering the volatility in equity markets.

As we prepare to conclude our 2020 review of Solvency II, we have seen that the proposals set out in our holistic impact assessment – notably on measures related to interest rate risk, proportionality, fostering long-term investment, and completing the macroprudential elements of the framework – published before the onset of the crisis, appear to have been validated.

It is also worth considering the Solvency II review in the wider context of European economic recovery. Our proposals related to sustainability, climate change and environmental, social and governance factors will help foster long-term investment in the green economy, thereby supporting Europe's Green Deal.

The pandemic has also shone a spotlight on protection gaps: in this case non-damage business interruption insurance. Again, in the wider context, Covid-19 has demonstrated the need to strengthen society's resilience to severe shocks as a whole, whether these are health-related, such as this pandemic, stem from climate-related natural catastrophes or large-scale sophisticated cyber attacks.

At EIOPA, we recently set out different approaches to shared resilience in a staff paper. The widespread nature of pandemics means traditional insurance risk transfer mechanisms may not be appropriate, making them too great a burden to be shouldered by insurance companies alone.

Instead, solutions involving both the public and private sector are needed. In short, we need to develop 'shared resilience' solutions that encompass proper risk assessments, investment in prevention measures, appropriate product design, and residual risk transfer.

For a resilient post-pandemic world, at least one thing is certain: insurance should be part of the solution, not part of the problem.

Insurance companies play an important role in Europe's financial services industry and economy and the strength of Europe's economy is underpinned by our ability to insure against the costs of future pandemics.

It is in everyone's interest to have a strong economy and a resilient society. To achieve this, we need solidarity and shared responsibility across all sectors of society: governments, public institutions, industry and civil society. Working together, with a common purpose, we can facilitate shared resilience.

Covid-19 has left us with many uncertainties. Nonetheless, for a resilient post-pandemic world, at least one thing is certain: Insurance should be part of the solution, not part of the problem. ●

Romain Paserot

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Covid-19: Impact on the global insurance sector and supervisory responses

The IAIS has been closely monitoring the impact of Covid-19 on the global insurance sector and is facilitating the sharing of information and discussion among its membership on supervisory responses.

Non-life insurers are impacted through increases in claims, particularly in business lines such as business interruption, travel and liability. Life insurers can be impacted through mortality shocks but also through investments, including the escalation of credit risk exposure to non-financial firms and sovereigns and the procyclical impact of large-scale rating downgrades. The IAIS is undertaking a targeted assessment of the impact of Covid-19 on the global insurance sector, focusing on solvency, liquidity, profitability and overall balance sheet exposures. The Covid-19 data collections have a quantitative and qualitative component and include data from insurers and IAIS member supervisors. By complementing the IAIS' quantitative analysis with the qualitative insights from insurers and supervisors into their own risk assessment, the IAIS obtains a more holistic view of the potential build-up of risks and vulnerabilities in the insurance sector during the Covid-19 crisis.

Initial analysis indicates that, so far, there has been a significant, but broadly manageable, impact on insurers' solvency and profitability, due to financial market turmoil and a disruption in new sales combined with increases in claims in certain business lines.

The Covid-19 crisis has served to further highlight the importance of cross-border supervisory cooperation and coordination. The global standards adopted by the IAIS in November 2019 provide more tools in the supervisory toolkit to take a coordinated approach to insurance group supervision. Firstly, ComFrame provides a globally consistent framework for both assessing (through, for instance, supervisory review and stress testing) and coordinating (through supervisory colleges and crisis management groups) a cross-border supervisory response for internationally active insurance groups (IAIGs). Secondly, the IAIS' holistic framework for the assessment and mitigation of systemic risk provides an enhanced set of supervisory policy measures for macroprudential purposes, designed to increase the overall resilience of the insurance sector and help prevent insurance sector vulnerabilities and exposures from developing into systemic risk. When a potential systemic risk is detected, supervisory powers of intervention should enable a prompt and appropriate response.

The Covid-19 crisis has also highlighted the relevance of a global group capital standard for IAIGs as part of ComFrame to provide a common language for group solvency discussions. Supervisory cooperation is paramount to the supervision of IAIGs and resilience of the sector. A global insurance capital standard is even more important in periods of global stress for the insurance sector. It would provide increased mutual understanding and greater confidence in cross-border analysis of IAIGs among group-wide and host supervisors, as well as contribute to better cross-sectoral dialogue.

The Insurance Capital Standard (ICS) Version 2.0 is currently at the beginning of a five-year monitoring period. The purpose of the monitoring period is to assess the performance of the ICS throughout the business cycle, to ensure that it appropriately and adequately captures and reflects risks in varying economic and financial market conditions. The current situation makes this year's monitoring exercise even more important, as the reliability of supervisory risk-based tools is critical in times of significant market movements and stresses. By collecting year-end 2019 data and a stressed balance sheet based on actual holdings as at end-March 2020, the IAIS will receive important information that will help deliver a sound global, group solvency framework at the end of the monitoring period.

In closing, while the global insurance sector has shown its resilience thus far, there are still many unknowns including the duration of the crisis and its full impact on the global economy. This highlights the need for continued dialogue between supervisors, insurers, policyholder representatives and standard setters in the face of continued uncertainty. The IAIS remains committed to support this global dialogue on appropriate responses to the crisis, by facilitating the sharing of information and analysing relevant data from global insurance groups and supervisors. ●

Alberto Corinti

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Lessons learned during the Covid crisis for consideration in the SII review

In general, the insurance sector has navigated the crisis quite well, but supervisors can certainly draw a number of lessons for the future. I would like to highlight three of them.

First, this crisis, mainly due to its non-financial triggers, is highlighting the urgency to take account of a number of risks that are normally not a priority for supervisors. I refer, for example, to those risks associated to the ability to continue to do business in a context of confinement measures, to the capacity, stability and security of IT platforms, to the legal and reputational risks deriving from unclear policy wording or, more generally, to the lack of fairness and transparency in the relationship with policyholders.

Certainly, these risks could be better mitigated before they materialize, through enhanced ERM policies and pre-emptive supervisory measures.

As to the more traditional risks for prudential regulation, in my view ▶

this crisis has confirmed the need to reinforce the management of liquidity risk by insurers. This risk, for understandable reasons, has not been considered key for the insurance business. We also have to acknowledge that no significant issues have emerged in this regard, at least at the current stage of the crisis. However, at least at the beginning, liquidity has been an obvious concern for both insurers and supervisors.

Supervisors have promptly set up enhanced supervisory reporting and some of them have even investigated the possibility to activate forms of extraordinary access to liquidity for insurers. It is clear, though, that what we would need first are proper measures on the governance of this risk by insurers. Supervisory reporting and other supervisory tools would work better in an appropriate ERM context.

Last but not least, the crisis has stressed the need to continue to work on how the prudential regulation behaves in times of financial market turmoil and, more precisely, on how to avoid that the interventions triggered in these situations by the solvency indicators end up to be too penalizing, useless or, above all, pro-cyclical. This includes at least two aspects. First, addressing the short-term, excessive volatility of market factors.

In Italy, during the hardest days of the crisis we had activated a weekly monitoring of the SCR ratio, which highlighted the extreme volatility of the indicator. Obviously, this could pose problems when it comes to transforming the warnings into concrete action, as the flexibility left to supervisors by the current framework is limited.

Addressing the excessive volatility of market factors, by the way, is an objective to achieve independently of the occurrence of a crisis. Secondly, it would be important to be able to activate a set of emergency measures that could reasonably soften the requirements when needed, to provide further flexibility for supervisory interventions.

The ability of insurers to stand difficult times depends on the risk measures that are in force in normal times.

These measures, although contingent to specific situations, should be applied in a timely manner and, for this reason, they should preferably be embedded in, and coherent with, the regular solvency framework.

The Solvency II revision should ideally consider all these aspects. Very often, the ability of insurers to stand difficult times depends on the risk measures that are in force in normal times.

Dominique Laboureix

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Adjusting the supervisory framework in light of the crisis: keeping momentum

The Covid crisis has showed the robustness of the insurance sector and the flexibility of the regulatory framework.

At present, two main first lessons can be drawn from the crisis. First, the current Solvency II counter-cyclical mechanisms have proved to be useful to mitigate the impact of market volatility on the balance sheet of insurers and to avoid pro-cyclical behaviors. For instance, the risk of incentivizing fire sales of equities has been limited, although there may still be the need to carefully analyze the consequences of the crisis and potentially strengthen these counter-cyclical tools. In that respect, European supervisors decided to have a closer look at the potential pro-cyclicality of the downgrades of certain debt instruments and bonds by credit rating agencies. Second, no specific liquidity issue among insurers has emerged so far. Insurers have built adequate liquidity reserves and have not been confronted with high demand in liquidity: claims remained constant and lapse rate drastically dropped.

If the insurance supervisory framework responded well so far, cautiousness is still warranted.

In addition to the use of Solvency II tools, supervisors took unprecedented supervisory measures to face the crisis, showing their ability to adapt to an

unexpected situation. On 2 April, EIOPA urged companies to temporarily suspend dividend distributions in order to strengthen their ability to deal with the crisis. Most European supervisors, namely the ACPR in France, followed this orientation, later extended by the ESRB to 1st January 2021.

It is also worth noting that the deferral of the implementation of IFRS 17 to 1 January 2023 will provide companies with additional time to review their transition options and adequately reflect the current economic outlook in the valuation of their obligations.

Looking ahead, regulators and supervisors have initiated discussions on a potential mechanism to cover losses related to business interruptions and to fill in the observed protection gap. As full insurability is probably not automatically possible, one of the key prerequisites for such a mechanism will be to find the appropriate mix between public and private financing.

From now on, ensuring sound and sustainable financing conditions for corporate, especially for small and medium-sized companies, to foster economic recovery, will be the main challenge. European insurers have a decisive role to play in this regard, given their business profile conducive to long-term investments. European insurers will also play an important role in supporting a sustainable transition. Finalizing and implementing the EU green taxonomy can contribute to this goal.

The impact of the crisis on insurers was dampened thanks to the Solvency II framework, but some targeted adjustments are worth being considered to improve it.

The pandemic has also, once again, shown that clear wording for insurance policies is essential and that insurers must accept claims when a pandemic situation coverage has not been clearly excluded by the contract. Globally, IDD is the other directive that insurers must comply with and take more into consideration.

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Covid-19: a long-term challenge for insurers' resilience

The Covid-19 crisis has dealt the insurance industry a double blow. The liabilities side of the balance sheets reflects the claims of the insureds arising from coronavirus-caused losses.

So far, the providers of credit and surety insurance, event cancellation insurance and plant closure insurance in particular have compensated their customers to the extent agreed by policy. In cases of doubt, they have often found amicable solutions. In Germany, while the increased claims expenditures have not overwhelmed the insurers' capacities, the impact on the undertakings' profitability has certainly been significant. We expect insurers to consider this in their capital planning and thus when making future distributions. What is more: when it comes to designing product features, the industry urgently needs to address the impact of pandemics. It is clear that this risk was not included in past calculations.

> *The crisis has dealt the insurance industry a double blow.*

On the assets side of their balance sheet, insurers have now benefited for several weeks from the fact that the market turbulence in March was followed by a stabilising effect and that the market values of their capital investments have recovered. The undertakings are reporting an increase in share prices and a decline in spreads. Both developments are having a favourable impact on the coverage ratio of the solvency capital requirement (SCR), which is at the same time under pressure again due to a declining yield curve. Moreover, quantitative data provided by the undertakings show that the volatility adjustment (VA) during the market turbulence has had a significant positive, stabilising effect on the solvency results.

The COVID-19 crisis is thus supplying valuable information on whether crisis instruments such as the VA are ultimately fulfilling the tasks they were designed to fulfil. But the undertakings' leeway for dealing with additional strain is becoming increasingly limited.

This means growing pressure to reach balanced solutions in the Solvency II review. Importantly and appropriately, EIOPA is postponing its recommendation to the European Commission regarding the overall Solvency II review from the end of June to the end of December 2020, to be able factor in the initial obvious lessons learned from the crisis. But it is also appropriate that we are not discarding the work done so far. Certain aspects of the review, such as reporting and thresholds, are largely independent of the coronavirus. In other respects, it is too early to draw any conclusions from the crisis for regulation.

The industry's resilience is not equally indicative of all undertakings. Some institutions for occupational retirement provision in particular were already experiencing major difficulties prior to the outbreak of the pandemic – especially in light of the low interest rate environment. Of the 135 *Pensionskassen*, about 35 are under intensified supervision. "Intensified supervision" means we increase the rate of contact and work with the undertakings to find suitable solutions for improving their situation, such as having sponsoring undertakings or shareholders provide financial support. But where these themselves end up in economic difficulties due to the pandemic, their willingness and capacity to support the *Pensionskasse* will also diminish.

Mireille Aubry

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Impact of the Covid-19 crisis on insurers and main lessons learned for the forthcoming S2 review

The Covid-19 crisis has so far manifested itself in four main ways. Firstly, and causing a marked impact on the solvency ratios of (re)insurance companies, the Covid-19 crisis has caused a financial turmoil associated with great volatility. In short and as a result, we are witnessing an exacerbation of the low interest rate environment and a repricing of spreads and risk premiums. German rates have initially fallen 70 bp then 20 bp and currently 40 bp compared to their end of 2019 levels. Equity indices remain around 20 percent lower than at the end of 2019. The solvency losses for insurers associated with these market movements are often around 20% to 30% of SCR coverage ratio points. But we must bear in mind that the impact of financial shocks on solvency ratios has been contained due to massive interventions by the European Central Bank (quantitative easing) and public authorities to varying degrees (solidarity funds, stimulus policies, unemployment benefits, various forms of allowances and aid, state-guaranteed loans.

Secondly, and resulting in a loss of profits, the impact of the Covid-19 crisis is mainly observed in the field of non-life insurance, with contrasting short-term positive and negative aspects depending on the lines of business, with the final net real impact still to be apprehended at the end of 2020 or even 2021. The positive short-term impacts come from the drop in the claims ratio, particularly in motor insurance. Conversely, the impacts are negative on the operating result of business interruption and event cancellations. Losses remain to be measured in the medium term in credit insurance.

Thirdly, a strong operational impact due to containment decisions has resulted in a need to organize business continuity for clients with employees on the basis of massive recourse to teleworking. The management of the crisis here has revealed a good degree of adaptation of insurers in particular thanks to the activation of business continuity plans with crisis teams. Yet, the situation proved to be conducive to the exacerbation of the cyber risk.

Finally, and fourthly, this crisis did not improve the image of insurance in the public eye and a reputational risk arose with business interruption guarantees poorly worded, which has been a source of litigation. This issue is related to the more general question of the place of insurers in resilience solutions and has led to discussions on the forms that insurance against the risk of a pandemic could take and what should be the place of insurers in the resilience solutions that our societies must develop for the greatest number of people. With regard to pandemic insurance, it emerges that effective coverage can only be assumed by insurers if adequate modelling of the frequency and severity of containment decisions associated with the management of a pandemic can be carried out and the burden of claims can be sufficiently distributed among policyholders and/or over time. We need to keep in mind that the effects of the crisis remain to be assessed against further developments both on the coronavirus and the economic sides.

As far as underwriting issues are concerned (claims and premium income) more adverse consequences are expected. For instance, what will future more broader changes in behaviors and business norms be and which consequences on the economy should be expected from current sovereign debts levels. More than ever, there is a greater need for volatility resilience. This should be a driving force for the coming solvency 2 revision. ●

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The role of the insurance sector in a changing economic landscape

In what we can define today as the greatest economic slump since the post-war period, the insurance sector continues to represent an element of resilience for the economy and for society as a whole. Equity indices clearly demonstrate the stability of the sector. The annual solvency capital generation remained strong: a drop of about 25% in solvency ratios was observed across Europe in Q1, well above the regulatory limit, and a rebound of about 10% is expected in Q2. The sector reacted promptly to face the impacts of the Covid-19 pandemic, maintaining operational continuity and customer service, protecting at the same time agents and employees, thanks to the intensive application of digital technologies and smart working.

On the business side, while the Life business has been impacted by the extremely low interest rates, a temporary reduction in claims in the Motor line will keep Non-life profitable almost everywhere, ▶

▶ even with additional services and discounts to customers. Health insurance is projected to grow steadily in a scenario of increasing demand for supplementary private health services.

In order to cope with the Covid crisis from a technical and operational viewpoint, the first task of every insurer is to accurately analyse and study its characteristics in order to predict its short- and long-term developments. It is crucial to manage all metrics, including asset valuation, solvency and accounting balance sheets. Our expectations are of prolonged government and central bank involvement, coupled with continued low interest rates. Medium/Long-term investments with considerable diversification - also in innovative and sustainable investments - are the strategies to be followed. On the liabilities side, there will be a delay in both premium payments and claims reporting; companies should carefully evaluate their claims and premium reserves.

> *Long-term insurance investments in sustainable/green assets should be better incentivised.*

Regarding the current revision of Solvency II, this crisis has clearly indicated two areas on which to focus. First, we must be bold and take this opportunity to review our business approach in line with the European Commission's commitment to the new "Green Deal". I believe we have all realised that what we perceive as a possible future problem is actually much closer and concrete, whether it is a global pandemic or the challenge of climate change. Long-term insurance investments in sustainable/green assets should be better incentivised.

The private sector is ready to make its contribution, but strong public institutions must enable the power of the financial industry to channel unprecedented amounts of capital towards innovative, sustainable and environmentally friendly economy. Second, the discernible volatility in the solvency ratios in the early stages of the crisis was mainly due to the inadequate functioning and calibration of the Volatility Adjustment mechanism. This tool is currently under revision at European level, but it is crucial to introduce further enhancements to make it more effective. ●

Joseph Engelhard

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Carpe Diem. Let's learn from this crisis

While the current crisis continues to play out, to date it has generally served to illustrate the resilience of the insurance sector. This is in part due to good management but also integration of lessons learned from the 2008 crisis into existing robust forward planning, risk and capital management, and investment portfolio adjustments. Faced with current headwinds, insurance companies are effectively navigating uncertain and volatile economic and market conditions. Moreover, insurance products and investments continue to protect customers, stabilize markets and invest in bonds that finance communities and national governments.

While we will be learning from this crisis for some time to come, one important point it drives home is confirmation of industry's consistent call for recognition of the impact of market consistent approaches, such as the ICS, to insurer solvency. Recent reports from various institutions continue to downplay the impact of market-consistent regulatory frameworks on the sector. While the persistent low interest rate environment is a key concern, the impact of inappropriate regulation should not be ignored. Frameworks that require approaches to liability valuation and asset liability matching that are overly sensitive to short term market movements sacrifice the ability to hold assets matched to liability duration to spot-in-time transparency.

The ultimate adverse impact is at consumer and market level with the withdrawal of much-needed long-term guarantee products and corresponding stabilizing investment in assets to match those liabilities. The IAIS have committed to an ICS economic impact study and are collecting data under monitoring period confidential reporting to assess how the ICS reacts under stressed situations. This is a good start, and we suggest it be extended and refined to assist with an evaluation of how the ICS might impact product availability and insurance markets if broadly adopted. However, much more needs to be done to understand and weigh the pros and cons of a market consistent approach, considering anticipated prolonged low interest rates and credit downgrades, to avoid unintended adverse consequences on consumers and markets.

> *...the impact of inappropriate regulation should not be ignored.*

The current crisis also demonstrates the relevance of the IAIS Holistic Framework as an effective means to manage systemic risk in the insurance sector. The IAIS and FSB are now appropriately focused on examining, in light of the current crisis, what activities might be transmitting risk to the financial sector or real economy. The unique origin of this crisis in particular highlights the importance of dialogue among diverse public and private sector participants to understand how risk transmission might occur. We applaud the IAIS for their launch of the Global Monitoring Exercise and its formation of "search parties" comprising IAIS, supervisors and IAIG CROs. These dialogues will prove invaluable in the identification of emerging risks and of the means to best manage them. ●