Associazione Nazionale fra le Imprese Assicuratrici

# Impact of COVID-19 on Insurance

**Some ideas for the (near) future**

**Webinar per PEOPLE, HR Community di ANIA SAFE:**
**"Il post lockdown: gli scenari assicurativi e il ruolo HR"**
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Dario Focarelli

Director General ANIA

Visiting Professor, Actuarial and Financial Modelling for Solvency II, Università Cattolica, Milano
Adjunct Professor, “ Tanaka Business School”, Imperial College London
Senior Fellow, "LUISS School of European Political Economy", Rome

# Agenda

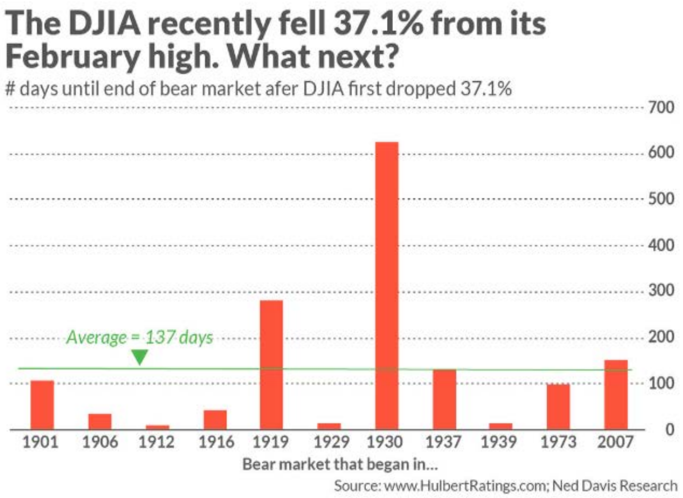
- Economic consequences of Coronavirus
  - Is the bear market already over ?
  - How bad the recession will be and how long will it last ?
  - Fiscal policy
  - Debt Sustainability
  - Role for coordination

- Insurance must be part of the solution
  - Essential service vs. public utility
  - Actions to manage and overcome the crisis
    - Liquidity
    - Solvency
  - Challenges for the future

# Is the bear market already over ?

- Difficult to say (almost a 50/50 challenge)
  - 11 bear markets in which the Dow fell by more than the 37.1%
    - On average, the final bear market low came 137 days after the 37.1% loss. Projected low on Aug. 7. Excluding the Great Depression: 90 days (Jun. 20).
    - However, in 5 out 11 cases less than 1 month

https://www.marketwatch.com/story/stocks-will-revisit-their-coronavirus-crash-low-and-heres-when-to-expect-it-2020-04-09?mod=home-page




- The US are in recession
  - NABE Outlook Survey panelists believe that the U.S. economy is already in recession. The consensus is real GDP declined at an annualized rate of 2.4% in the first quarter of 2020, and will shrink at an annualized rate of 26.5% in the second quarter. All estimates have a huge dispersion.
  - Unemployment rate is expected to spike to 12% by midyear (3.8% in Q1), while the United States may lose 4.6 million jobs in the second quarter

https://files.constantcontact.com/668faa28001/765a4afd-4ed3-4ea0-b98b-ae631771042b.pdf

# How bad the recession will be and how long will last ?

## Latest World Economic Outlook Growth Projections

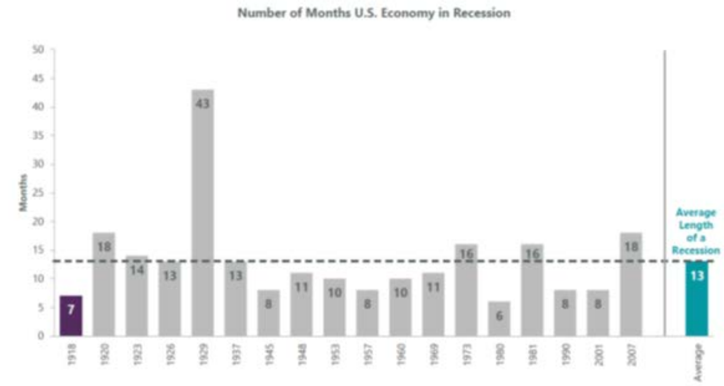
The COVID-19 pandemic will severely impact growth across all regions.

| (real GDP, annual percent change) | 2019 | 2020 (PROJECTIONS) | 2021 (PROJECTIONS) |
|---|---|---|---|
| **World Output** | **2.9** | **-3.0** | **5.8** |
| **Advanced Economies** | **1.7** | **-6.1** | **4.5** |
| **United States** | 2.3 | -5.9 | 4.7 |
| **Euro Area** | 1.2 | -7.5 | 4.7 |
| Germany | 0.6 | -7.0 | 5.2 |
| France | 1.3 | -7.2 | 4.5 |
| Italy | 0.3 | -9.1 | 4.8 |
| Spain | 2.0 | -8.0 | 4.3 |
| **Japan** | 0.7 | -5.2 | 3.0 |
| **United Kingdom** | 1.4 | -6.5 | 4.0 |
| **Canada** | 1.6 | -6.2 | 4.2 |
| **Other Advanced Economies** | 1.7 | -4.6 | 4.5 |
| **Emerging Markets and Developing Economies** | **3.7** | **-1.0** | **6.6** |
| **Emerging and Developing Asia** | 5.5 | 1.0 | 8.5 |
| China | 6.1 | 1.2 | 9.2 |
| India | 4.2 | 1.9 | 7.4 |
| ASEAN-5 | 4.8 | -0.6 | 7.8 |
| **Emerging and Developing Europe** | 2.1 | -5.2 | 4.2 |
| Russia | 1.3 | -5.5 | 3.5 |
| **Latin America and the Caribbean** | 0.1 | -5.2 | 3.4 |
| Brazil | 1.1 | -5.3 | 2.9 |
| Mexico | -0.1 | -6.6 | 3.0 |
| **Middle East and Central Asia** | 1.2 | -2.8 | 4.0 |
| Saudi Arabia | 0.3 | -2.3 | 2.9 |
| **Sub-Saharan Africa** | 3.1 | -1.6 | 4.1 |
| Nigeria | 2.2 | -3.4 | 2.4 |
| South Africa | 0.2 | -5.8 | 4.0 |
| **Low-Income Developing Countries** | 5.1 | 0.4 | 5.6 |

Source: IMF, *World Economic Outlook*, April 2020

## How Long Does the Typical Recession Last?

On Average, Recessions Have Lasted 13 Months




▸ **The 1918 recession, which occurred amidst the Spanish Flu, lasted about half as long as a typical recession.**

https://www.leggmason.com/content/dam/legg-mason/documents/en/insights-and-education/presentation/presentation-anatomy-of-a-recession.pdf

*"This is already shaping up as the deepest dive on record for the global economy for over 100 years. Everything depends on how long it lasts, but if this goes on for a long time, it's certainly going to be the mother of all financial crises."*
Kenneth S. Rogoff

https://www.nytimes.com/2020/04/01/business/economy/coronavirus-recession.html

# Fiscal policy (Blanchard)

1. Infection fighting
2. Disaster relief. People, firms---eventually financial institutions?

    Upper bound on the cost? Decrease in output: 35% of baseline under lockdown. 40% of households and firms are liquidity constrained. Replacement rate: 80% (the State replace 32% of lost income). One month of lockdown cost 11% (35%*32%). Assume 2 months at lockdown and 6 months at half lockdown (5 months of total lockdown).

    All grants: 5% of baseline GDP (Blanchard)

3. Aggregate demand management

    Phase 1

    Lockdown implies potential output down by 35%.

    Disaster relief could lead to too much demand. But some inflation, not a major issue

    Phase 2

    As lockdown is relaxed, will private demand go up or down?

    Pent up demand, may dominate at the beginning

    But also, uncertainty will produce precautionary saving and low investment ?

    Bottom line: We don't know and it is better to have contingent commitment

https://www.piie.com/blogs/realtime-economic-issues-watch/whatever-it-takes-getting-specifics-fiscal-policy-fight-covid

# Debt Sustainability (Blanchard)

- Is debt sustainable? Assume the crisis leads to a 30bps increase of GDP
- Answer for Advanced Economies: Yes (Unless the virus wins !!!)
  - R* (the neutral rate) is low and is likely to be even lower after the crisis:
    - If Uncertainty will lead to precautionary saving and lower investment
  - Interest rate will increase but still lower or close to the rate of growth
    - 2-4 bps per 1% of additional debt: so 60bp-120bps
- Different answer for Italy and Developing Economies
  - Italy
    - Important role of ECB in avoiding multiple equilibria
      - "Good equilibrium:" debt sustainable at the safe rate
      - "Bad equilibrium:" worries, higher rate, debt unsustainable
  - Emerging markets
      - hit not only by the virus but also by the fall in commodity prices (if they are exporters) and large capital outflows by investors who need liquidity at home
      - Helping emerging-market and developing economies is a major and urgent issue, It is tough for advanced economies, confronted with the crisis at home, to be generous. But it is essential that they be

https://www.piie.com/blogs/realtime-economic-issues-watch/whatever-it-takes-getting-specifics-fiscal-policy-fight-covid

# Role for coordination

*"We find ourselves afraid and lost... We were caught off-guard by an unexpected, turbulent storm. We have realized that we are in the same boat, all of us fragile and disoriented... all of us called to row together, each of us in need of comforting the other."* Pope Francis

- Coordination is highly desirable but it is difficult/unlikely to achieve (example)
  - Fighting for masks (and possibly in the future for tests, cures, and vaccines)
  - Disagreement at the Euro level on how to finance the recovery
  - Even geopolitical divergences on the assistance to fight coronavirus

# Insurance should be part of the solution

- In many European country insurance has been defined an "essential service"
  - On the positive side: the social role of insurance is reinforced
  - On the potential negative side: insurance as a public utility not as a well functioning private market

- Pressure from Governments for a "generous" reading of contract clauses to ensure that COVID-19-related costs can be covered (e.g. in health insurance or insurances for companies)
  - *"However, where coverage for pandemics and other causes of loss were not included in existing policies or reflected in premium payments, requiring insurers to cover those losses retroactively could seriously threaten the stability of the global insurance industry."* GFIA statement https://gfiainsurance.org/news/320/gfia-statement-on-covid-19
  - *"As a general principle, imposing retroactive coverage of claims not envisaged within contracts could create material solvency risks and ultimately threaten policyholder protection and market stability, aggravating the financial and economic impacts of the current health crisis."* EIOPA statement https://www.eiopa.europa.eu/content/call-action-insurers-and-intermediaries-mitigate-impact-coronaviruscovid-19-consumers_en

# Insurance should be part of the solution

## Actions to **manage and overcome the crisis, and get ready for the "new normal"**

| Immediate actions | Priorities for up to 3 months | How to reach a "pandemic vaccinated business model" |
| --- | --- | --- |
| Protect your people first | Check stress scenarios to evaluate impacts of the turmoil | Take M&A into consideration, and define your strategy |
| Set-up business continuity actions | Accelerate the digitalization of your customer base | Review and adjust customer strategy |
| Adjust the operating model | Speed up investment decision making process | Structurally evolve your operational model |
| Protect your clients | Tactically reduce cost base | Embed New Ways of Working |
| Communicate adequately | | Structurally evolve your digital distribution model |

**Align and communicate with stakeholders**

**Visibly act responsibly (ESG/CSR)**

Source: Bain & Company

# Liquidity position of the insurance market

1. the exceptional volatility of financial markets put pressure on companies' liquidity
   - Higher margins on derivative markets
   - Surrendering on linked products, when a portion of assets is illiquid
2. the insurance industry, like other businesses, is experiencing:
   - a very sharp decline in the new business
   - late/suspension payments from policyholders

   … while …
   - meeting its commitments on time
   - offering support and liquidity to agents and clients
3. an increase in surrendering life policies might occur in case of an intensification of the global recession

- These trends may result in a compression of companies' liquidity and/or forced sell of securities in a depressed market
- Do insurance companies need access to CBs facilities ?

# Liquidity position at company level

- A realistic and comprehensive liquidity planning is necessary for each company (e.g. EIOPA asked for weekly data to monitoring purpose) with special focus on:

1. Exposure to derivative markets
2. Liquidity of assets in portfolio (including those backing linked products)
3. Management of cash flows
4. Analysis of the life insurance policy lapses, loans and surrender activity

# Solvency position of the insurance market

- Stock valuations plunge, lower/negative risk free rates and wider credit spreads create relevant asset liability management risks for life insurers
- Risk-based capital approaches vary widely by jurisdictions, therefore the reaction of capital ratios to current market conditions changes
  - EU Solvency II is probably the most sophisticated framework but it is very sensitive to financial market volatility
  - Solvency II is currently under a comprehensive review, which was supposed to finish this year
    - During the review the need for improvement emerged, to better counteract the procyclicality effects of a system based on punctual market values, applied to a sector that has most of its business long-term oriented
    - Huge fluctuations (at least 50bps decrease for SCR ratio) during the second half of March
    - This concerns, in particular, the Volatility Adjustment mechanism, the risk margin calculation, the treatment of equities and deferred taxes
  - It is unrealistic to end the review on time
  - It is better to prepare for a quick fix approach

## Elements existing in the Solvency II framework that could help mitigate the impact of COVID-19

- Transitionals on technical provisions
  - There is broad agreement that transitionals are a legitimate method for mitigating impact of interest rate volatility
  - Some markets and some companies within those markets are making use of transitionals, others are not
  - A rigors analysis of cost and benefit should be performed at company level

- Article 138 on extension of the recovery period
  - Supervisory authorities may, under certain circumstances, extend the recovery period for the re-establishment of compliance with the SCR by a maximum period of 7 years.
  - This power applies in the event of exceptional adverse situations affecting insurance and reinsurance undertakings representing a significant share of the market or affected lines of business, where undertakings fail to fulfil their SCR.

# Challenges for the future (1/2)

- Making healthcare more available and accessible
  - a rapid increase in telehealth services might foster the interest of uninsured
  - the pandemic might persuade more people to reconsider their needs, with rising sales of health insurance, critical illness and life coverage

- Develop products covering epidemics
  - how to protect more businesses and individuals than has been the case with COVID-19 ?
  - Cover against pandemics is impossible without state support (and possibly even with such support) … but we should start thinking about new solutions
  - What kind of coverage ? What is the optimal geographical size of the pool ? How to involve financial markets ?

# Challenges for the future (2)

- Offer better protection for older people in a «lower for longer» interest rate environment
  - Both life insurance and annuity products might be used for long-term care (and/or medical care) and the full death benefit or cash value should be available where care never/partly used

- Support a comprehensive (EU) recovery plan integrating the green transition and digital transformation, while meeting both financing obligations and fiduciary duty
  - Long term investors might match their liabilities by investing in such plan
  - Crucial point is a regulation which do not penalize long term investment, forcing a 1-year horizon evaluation
  - Tax incentives for final investors who accept a given degree of illiquidity to their policies might prove to be effective

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