

COVID-19: Insurance impact and response

April 2020

Contents

01

Impact of the pandemic on the industry so far

03

Plausible pandemic scenarios

05

People, operations and technology

07

Financial reporting and operations

02

Planning in the face of uncertainty

04

Product, customer and distribution

06

Capital, liquidity and investments



Impact of the pandemic on the industry so far

Business continuity planning has mostly worked

Most insurers have moved relatively seamlessly to business continuity:

- ▶ Business continuity protocols have been actioned, tested, and seem to be working.
- ▶ Some isolated, specific issues noted. E.g., a need to stand up back-up call centers and the ability to e-sign contracts.
- ▶ Increasing pressure on offshoring and BPO capacity especially in India.
- ▶ Long-term sustainability of current working models is untested, including dealing with illness, impact of schools closing, cultural aspects of teaming, and ability to change user access permissions etc.

Insurers have seen significant share price falls

Insurance share price sell-off has been driven by a number of factors:

- ▶ Look through mark-to-market of balance sheets to equity, credit spread and interest rate movements. Life insurers with large books of guaranteed liabilities, and limited new business, have been most impacted.
- ▶ Reinsurance companies were perceived to have exposure to large claims losses. This perception is being reversed.
- ▶ Individual company factors, either business mix, specific asset exposures or general concerns around business performance and longer term viability.

Underwriting exposures have been limited

Selected classes are heavily exposed, but broadly there has been a resilient outcome:

- ▶ Travel, health, event cancellation, credit and surety are seeing, and are expected to see, large claims volumes.
- ▶ Premium volumes are falling in aviation and marine, and some insurers have stopped writing new travel. Premium holidays are having significant impact on liquidity in some markets.
- ▶ Many non-life policies have pandemic exclusion. Business interruption often requires physical loss to be triggered, and businesses need to be solvent for coverage to apply. This is under pressure from politicians.
- ▶ Mortality exposure is not currently at a material level.

Reactions to market movements

Insurers are updating markets on solvency:

- ▶ Share buybacks are being suspended but dividends are being preserved for now, but subject to regulatory scrutiny. Several countries including Norway, Poland and Canada have stopped dividends in anticipation of stress.
- ▶ Regulators are being publicly and privately supportive, including a public statement from European insurance and occupational pensions authority (EIOPA). Many regulators have data requests out to the industry, and there is regular solvency monitoring.
- ▶ Rating agencies are also starting to re-evaluate. A number of businesses require a minimum single "A" rating to be viable, and some ratings appear vulnerable.

Planning in the face of uncertainty

Insurers are confronting the new reality in which the COVID-19 pandemic is a long-term disruption to their customers, employees, investors, and suppliers. **The scope, duration, and severity of the threat is, as yet, unknown.**

What tools do insurers have to confront this crisis? What tools need to be built to face these unprecedented challenges? How can insurers learn from this crisis and emerge with a strong business model as a result?



Now

How do insurers proactively serve **policyholders in a time of strain**? How does the industry manage coverage **exclusions and respond to government intervention**? How do insurers **manage solvency and liquidity** strains?



Next

How do insurers recover new business and growth plans through **product design and inventive distribution channels**? What can insurers do to manage investments and take advantage of investment opportunities including **M&A opportunities**?



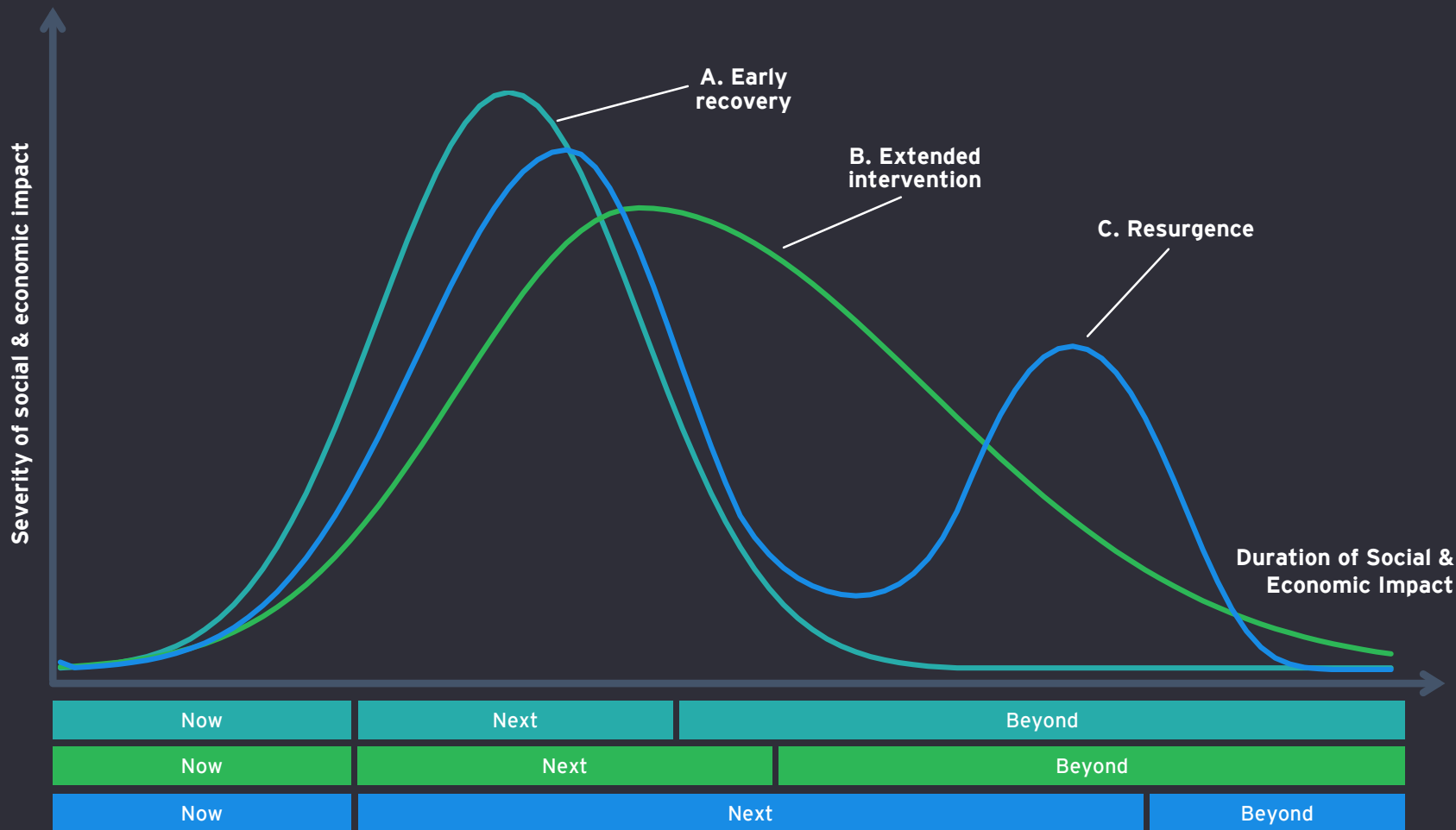
Beyond

How can insurers use learnings from this crisis to create a **more flexible, cost effective organization**? Are **products and digital offerings**, responding to changes in behavior, to protect against future risks and preserve trust and purpose?

As circumstances change, and new issues emerge, insurers require an agile approach to strategic planning.

Plausible pandemic scenarios

The COVID-19 pandemic is accelerating our information lifecycle, increasing the risk that outdated or incorrect data will result in poor decision making. EY teams have combined the views of medical professionals, economists, and industry analysts into three representative scenarios to guide the dynamic planning process.



● Early recovery Scenario A

Strong public health response and the virus seasonality slow and contain the spread of COVID-19. Quarantines and travel restrictions drive sharp contraction in consumer spending, but economy - supported by fiscal and monetary intervention - bounces back quickly. Continuity planning and remote technologies alleviate workforce disruptions.

● Extended intervention Scenario B

Countries struggle to contain the virus due to disorganized response and variable enforcement. Global recession caused by declining consumer spending and corporate investment continues even as infection rates decline seasonally. Global spread of the virus strains business's supply chains, sustained contraction prompts lay offs and structural realignments, and technology constraints on remote workers depress productivity.

● Resurgence Scenario C

Public health and economic measures lifted as the virus abates, and public and policy makers caught off-guard by a second wave of infections. Public fatigue dampens political appetite for further market intervention and industry "bailouts". Insurer operations struggle to keep up with customer activity and government action, and workforce attrition increases operational and cyber risks.

Challenges for insurers

We see the threats and opportunities facing insurers sitting across four core areas which all have significant ramifications for the reputational, financial and operational resilience of the industry.

Customer, product and distribution

1. An unparalleled **volume of customer queries** and stakeholder engagement, with significant **strain on traditional distribution** channels.
2. Whilst many policies exclude pandemic losses, the public focus means significant **reputational risk and cost arising from government interventions** in the market.
3. There are **commercial opportunities** to improve customer centricity, grow market share, accelerate digital business models and develop new products.

Capital, liquidity and investments

1. **Solvency ratios and holding company liquidity will come under pressure** as asset values fall and capital requirements are stressed.
2. Insurers who have adopted **more risky asset strategies will come under strain** (particularly illiquid asset holdings) and as crisis continues will need to review strategy, as losses are realized, as the crisis continues.
3. Cashflow strains will be seen, **premiums volumes will fall** and **some claims payments will be accelerated** as a result of COVID-19.

People, operations and technology

1. Huge **disruption to the workforce**. Severe pressure on normal teaming, sales activity and human interactions, combined with **stress in personal lives. Mental and physical wellbeing** are strategic priorities.
2. Offshore and some onshore centers are under strain with many closed, and **struggling to operate effectively remotely**, impacting customer experience at a critical time
3. A rapid transition to remote working is exerting pressure on IT and security teams and insurers need to address the **next wave of cyber security risks**.

Financial reporting and operations

1. Reporting processes will be **under pressure from staff shortages, new ways of working and significant financial uncertainty**, adding complexity.
2. Many **critical projects need to continue at pace** (particularly IFRS 9 and 17) and operate efficiently in a new environment.
3. **Maintaining the control environment** as processes come under stress and workforce challenges play out, will be critical.

Non-life product, customer and distribution impacts are significant. The insurance industry must react proactively to demonstrate its purpose.

Non-life and specialty insurers need to respond quickly to customer and stakeholder needs, whilst supporting the wider economy and maintaining commercial opportunity.

Unparalleled volume of customer queries and stakeholder engagement

- ▶ A wide range of global stakeholders are making proactive contact, with touchpoints across the value chain.
- ▶ The role of the intermediary remains crucial as the customer interface, particularly in the commercial and specialty space, thus, response needs to be across the value chain.
- ▶ Insurers need a clear and consistent response on coverage and claims processes, e.g., on Business interruption (BI) coverage.
- ▶ Response now will shape policyholder trust and behavior for years to come. How will policyholders be confident future events and risks will be covered?

All stakeholders are seeking a level of industry consistency on coverage and exposure, underpinned by rich data.

An appropriate balance of solvency, customer protection, regulatory and legal requirements is vital - potentially underpinned by government support.

Significant commercial considerations - including upside opportunity

- ▶ Retention rates are expected to be high over coming months, as clients choose to remain with familiar insurers and brokers.
- ▶ Insurers will need to take a view on extending renewal dates and rolling over structures.
- ▶ A focus on supporting existing customers is essential, though this will transition to new products for new customers over time.
- ▶ New ways of engaging customers and developing new business must emerge quickly - distinct customer value propositions for the "new normal" will support differentiation.
- ▶ New captive solutions are likely to emerge, potentially for affinity-style groups who have identified gaps in cover.

New products are already being launched to mitigate impact of COVID-19 e.g., Thailand & Italy.

Early thinking on future customer needs will drive benefit for all stakeholders.

The insurance industry have a crucial role to play to support the economic recovery

- ▶ Overarching purpose of insurance is likely to be questioned if the industry is not perceived to be working together to support economic recovery.
- ▶ The industry should consider how they shift their focus from short term impact to the overall role of insurance in the economy.
- ▶ Existing structures could be used in conjunction with government bodies to get support to businesses with a protection gap, and to provide additional capacity and cashflow to insurers if required.
- ▶ Proactive industry action is likely to be highly beneficial to long term recovery.

Regulators and government are already exploring options to use the insurance industry as a vehicle to support businesses.

Legal action in the US indicates the potential risk if no proactive action is taken, jointly with government.

Life product, customer and distribution impacts are significant. The insurance industry must react proactively to demonstrate its purpose.

Life insurers will need to adapt to a redrawn product and distribution landscape for new business, while continuing to support the in force against a very challenged economic backdrop.

Product landscape likely to be materially redrawn:

- ▶ Consumer value proposition of conventional savings products are challenged: guarantees are expensive to provide, and market risk products exposure customers.
- ▶ Protection claims volumes are unlikely to be materially impacted, given the affected age groups and coverage exclusions.
- ▶ Potential for longer term growth given demonstrable need for protection, and as products evolve to meet demand or match coverage requirements.
- ▶ Traditional “static” long-term products replaced by shorter term coverages or products that evolve with changing requirements.
- ▶ Greater use of data and analytics for underwriting & pricing.

Customer experience will be key to mitigating downside risk:

- ▶ There is short-term backlog potential, given the impact of legacy systems and difficulty to execute work-from-home model.
- ▶ Speed of processing is key to managing reputational risk, but shifting to online increases potential cyber exposure.
- ▶ Pensions customers are unlikely to move into decumulation phases as they wait for market conditions to improve and give better investment returns.
- ▶ Increased future demand for self-service capabilities are likely to put further pressure on legacy areas and impact ability to deliver new ways of working.

Evolution of distribution landscape will see shift away from face-to-face:

- ▶ Distribution has been traditionally face-to-face and heavily focused on life events (i.e. mortgage sale).
- ▶ Short-term impact will be higher protection sales, but pension sales lower with fewer people in employment and a depressed investment outlook.
- ▶ Digital channels are likely to increase - both to fill the gap, but also as the population thinks more about protection going forward.
- ▶ The distribution model will need to be adapted to phone, video and more supported on-line activity to survive and there is potential for material cost savings.

Insurers will need to re-base their life offerings, and consider “known unknowns” and downside risks.

New products will need to be tailored to meet demands, while balancing the needs of all stakeholders.

Reputational risk is heightened by the need to execute flawlessly in the new ways of working.

Pressure on legacy systems and platforms has increased, and will continue to do so in the future.

Is the existing distribution model fit-for-purpose? How quickly should the model evolve?

Interaction with policyholders will change significantly as self-service increasingly dominates.

Product, customer and distribution actions

Insurers and brokers should coordinate action across their value chains. This crisis is accelerating the fundamental trends already important across the industry.



Now

Align, and continually refresh, clear and consistent messaging to customers and other stakeholders across the value chain

Implement a smart triage system to handle incoming voice and digital queries; develop a proactive outbound engagement plan

Establish dedicated team focused on future horizons, including purpose, economic scenarios & commercial considerations

Work with government bodies to identify a pragmatic approach for industry to support economy

Next

Reboot new business activities, especially in retail insurance. Consider accelerating shift in sales channels, and cost effectiveness of traditional models.

Stand up new product development capability targeting newly identified customer needs and groups

Develop and communicate a distinct customer value proposition for the "new normal" to support new business activity

Beyond

Codify new ways of working into customer engagement, trading and operational processes

Consider new commercial structures and partnerships that best respond to future customer needs

Engage with capital providers to get support for new products and approaches

People, operations and technology will need to evolve rapidly in response to the pandemic

EY believe insurers have a number of threats and opportunities facing them as they respond to the pandemic crisis:

Some contact centers and operations are struggling to operate effectively remotely:

- ▶ Service levels need to be maintained, but some are having to limit service to customers. Insurers should rapidly leverage technology (such as virtual assistants) to maintain service.
- ▶ The third-party supply chain will be impacted in different ways and where needed, alternate arrangements should be put in place or rapid automation should be introduced.
- ▶ There is a need to collaborate with a newly-remote workforce using cloud-enabled ERP and Modern Desktop tools, and support and engage your people in adapting to this new way of remote working.

Modern collaboration tools will power a permanent shift away from office-based teams.

Third party risk management is part of core operational monitoring, as financial or people issues stress suppliers.

Remote and new ways of working is introducing new or heightening existing risks:

- ▶ Insurer's control and security frameworks will be under stress and will need re-looking at in light of new ways of working.
- ▶ People working from home and across distributed teams with less effective internal control environment could lead to fraudulent activities and requires a new approach to risk management.
- ▶ Insurers are being confronted with an evolving landscape of cyber threats resulting from the impact of the pandemic.
- ▶ These shifts in cyber risks will also impact insurers customers and third parties introducing new products and coverage.

The current crisis is dramatically increasing cyber threats for businesses as workforces transition to home working.

Risk of fraudulent activity by both employees and customers is heightened under new ways of working.

The home office experience will accelerate newer ways of working, and have profound cultural impacts:

- ▶ As insurers adapt their offerings, they will need to ensure their people, operations and technology are able to adapt to this new product and distribution suite.
- ▶ The rapid shift in ways of working will push insurers to review what is required in the workforce of the future, and create a more flexible organization. Embedding the best of new and old cultures will be a strategic HR challenge.
- ▶ The crisis will accelerate plans for digital front and back office transformation in both sales, service and claims across all distribution channels.
- ▶ Cost pressures, and efficiency, will remain high on the board agenda. Harnessing change will also drive bottom line benefits from a more efficient, digital organization.

Personalized, flexible, usage-based products will become more prevalent.

Data and insight will give insurers a better view of their customers' needs beyond insurance.

People, operations and technology actions

EY believe insurers have opportunities to respond to these across the pandemic lifecycle



Now

Rapidly review business capacity constraints and non-critical processes - prioritize, re-purpose, automate, stop or postpone

Look after your people: focus on physical and mental wellbeing, and ensure connectivity and engagement survive the loss of the office experience

Understand and address risks of remote working strengthening cyber risk capability

Introduce virtual assistants to manage and maintain service, and instrument existing sales & service processes

Assess the options for 3rd party support to provide burst capacity and to address off-shore center challenges



Next

Enrich digital channels to adapt to new ways of customers buying insurance products, and scale digital servicing for customers

Deploy cloud technology to effectively scale infrastructure in response to demand

Create new products and experiences for sales and service of protection products to match urgent market need



Beyond

Look hard at the operating model and future impact of the spike in digital adoption, and identify and create new flexible operating model

Redesign operating model to optimize the balance of internal vs. external providers, use AI to enhance people capability, level of straight through processing and automation

Introduce Agile at scale across the business and IT function and, transform the change delivery model

Adapt operating model to new product suite that arises out of this crisis

Capital and liquidity challenges for insurers will continue to evolve, while the potential for regulatory relief is currently unclear

While there are different drivers, we expect insurers across the sector to have pressures on capital and/or liquidity:

Significant and immediate impact on solvency positions:

- ▶ Immediate hits to solvency position, with lower interest rates, widening spreads and equities down.
- ▶ While disclosed solvency positions show material buffers above minimum thresholds, companies may need to take action to maintain solvency - e.g., dividend reductions and cancellations.
- ▶ Regulators will be closely monitoring positions, and are keen to avoid procyclical behavior. Any regulatory relief may come at a cost to dividends and bonuses.

Emerging liquidity pressures from a number of sources:

- ▶ Operational cashflow strains, such as premium holidays, margin calls, along with societal pressure to contribute to the broader economic recovery, etc. are putting strains on insurers' liquidity.
- ▶ Customers may stop premium payments, while life insurers are likely to see an increase in withdrawals from savings products. Early redemptions will place strain on Asset Liability Matching (ALM), and may force insurers to sell assets below par.
- ▶ Potential downgrades to (re)insurers could result in material business outflows and collateral calls.

Earnings pressure and evolving credit risk as mitigation actions are worked through:

- ▶ Insurers will face shrinking revenue, as life policyholder investments sit at lower levels, non-life insurers see reduced premium volumes (e.g., aviation, marine) and, as certain products become less attractive, providing a drag on future earnings and capital generation.
- ▶ Unprecedented actions from government to protect the wider economy, but there is likely to be a higher level of negative rating actions, and ultimately defaults. Interest rates expected to be lower for longer.
- ▶ Life insurers with illiquid assets are coming under pressure as investors look through to mark-to-market balance sheet impacts.

Insurers will need frequent monitoring of capital and liquidity, as well as revised strategic plans and scenarios.

Capital optimization and hedging activities to preserve and protect capital position.

Insurers will need to proactively consider changes in client/customer behavior and the impact on liquidity.

Pro-active communication with regulators, rating agencies, and other key stakeholders.

Thorough review of liquid and illiquid asset exposure to identify potential default triggers and covenant risk.

Earnings will come under pressure as revenue shrinks and claims costs are increased for some lines.

Capital, liquidity and investment actions

EY believe insurers have opportunities to respond to these across the pandemic lifecycle:



Now

Ensure robust liquidity plans to be able to absorb cashflow stresses

Assess capital management levers, and develop up-to-date scenario plans with clear triggers for capital preservation actions

Consider the need for product-level actions, such as gating of certain products/asset classes to preserve liquidity and value



Next

Active asset portfolio management, particularly in respect of ratings migration, credit loss mitigation and hedging programs

Review risk appetite and capital allocation strategies, including business portfolio. Consider M&A as an active lever to invest and disinvest

Ongoing stakeholder engagement, covering policyholders, investors, rating agencies and regulators



Beyond

Implement changes to product portfolio to address new economic environment, and to balance front and back book

Review and update capital and liquidity recovery plans and resilience-testing arrangements

Anticipate and prepare for regulatory evolution in the post-crisis environment

Financial reporting will come under strain as the current environment introduces significant risk to financial reporting processes

With increased demand and strain of resources, we expect insurers across the sector to have pressures on their financial reporting processes:

Financial close will take longer with a remote workforce:

- ▶ Operational continuity and resilience will be tested including identification of critical resources, technology and vendors.
- ▶ Likely capacity issues, knowledge gaps and access to critical systems and data may be limited putting strain on processes.
- ▶ Availability of third party data from distribution partners and outsource providers may be reduced or delayed.
- ▶ Increased production time will squeeze time for management review. Close activities may need to be reviewed and re-sequenced.
- ▶ Deviation from usual processes will require an updated risk and control framework, with specific monitoring of critical and reinforced controls over journal entries.

Back office staff appear to be better prepared for working from home, but in some cases they are having to sacrifice their laptops for front office.

Control environment will be strained and there will be a need for increase focus on cash processes to manage heighten fraud risk.

Increased demand on, and need for, judgement will increase pressure on finance teams:

- ▶ Market volatility will drive increased requirements and analyses, in particular: Solvency, premium adequacy tests, insurance contract liabilities, and the most sensitive assets (goodwill, assets under IAS 39, DAC), as well as added tax matters.
- ▶ Business interruption combined with significant claims activity may result in incomplete information, from upstream operational activity, to support accounting judgments and earnings guidance.
- ▶ Reserve reviews become more complex as coverage and key assumptions need to be carefully considered.
- ▶ Greater off-cycle reporting to boards, regulators, investors and other stakeholders.

Finance and actuarial teams are being asked for increasing levels of analysis and reporting as the situation evolves.

Additional judgement and assumptions will be required as we face into a period of uncertainty.

Large projects, such as IFRS 9 and 17, will need to continue. Current market conditions may stress design principles:

- ▶ Despite the delay in IFRS 17 adoption, many programs required the additional time.
- ▶ Many insurers have been less focused on metrics and business steering to date. This will become doubly important as existing metrics are reappraised, as a result of COVID-19, and earnings guidance is withdrawn or amended.
- ▶ Opportunities to accelerate finance transformation, benefitting from COVID-19 driven culture and working model shifts.
- ▶ Further opportunities to streamline process and reduce the book of work, as quick fixes become tested and embedded.

Large projects continue, and deadlines need to be met.

Grasp the opportunities from resource scarcity to eliminate, redefine or automate processes.

Financial reporting and operations actions

Insurers shouldn't stop at the tactical response, they should look ahead to planning future close periods to de-risk critical path



Now

Setup a virtual command center and align SWAT team to deal with accounting, actuarial and treasury, tax, IT and investor issues in real-time

Prioritize critical path process and controls over the non-essential and assess critical process resilience and tactical mitigation action

Scale up remote capacity - connectivity, platform scaling, laptop build and IT support, including vendor support during critical close

Identify key people and ensure immediate continuity, and assess the options for 3rd party support to provide burst capacity



Next

Review and refine service levels e.g., what stops in the event of constraints or events looking towards the next reporting cycle

Re-plan close process and build contingency plans based on scenarios (e.g., quarantine extension) and continuously improve

Look to automate and leverage quickly deployable technology to support production and analysis

Assess business impacts and how actuarial models can effectively monitor and manage this e.g., with additional exposure data



Beyond

Lift up data and technology capability across finance to increase visibility over evolving business and support cost reduction

Consider emerging technologies, e.g., claims automation and analytics, fraud management technology, and disease and outbreak modelling

Consider alternative models to provide stronger business continuity response, e.g., managed service for actuarial

Align investor relations messaging with the wider purpose of insurance

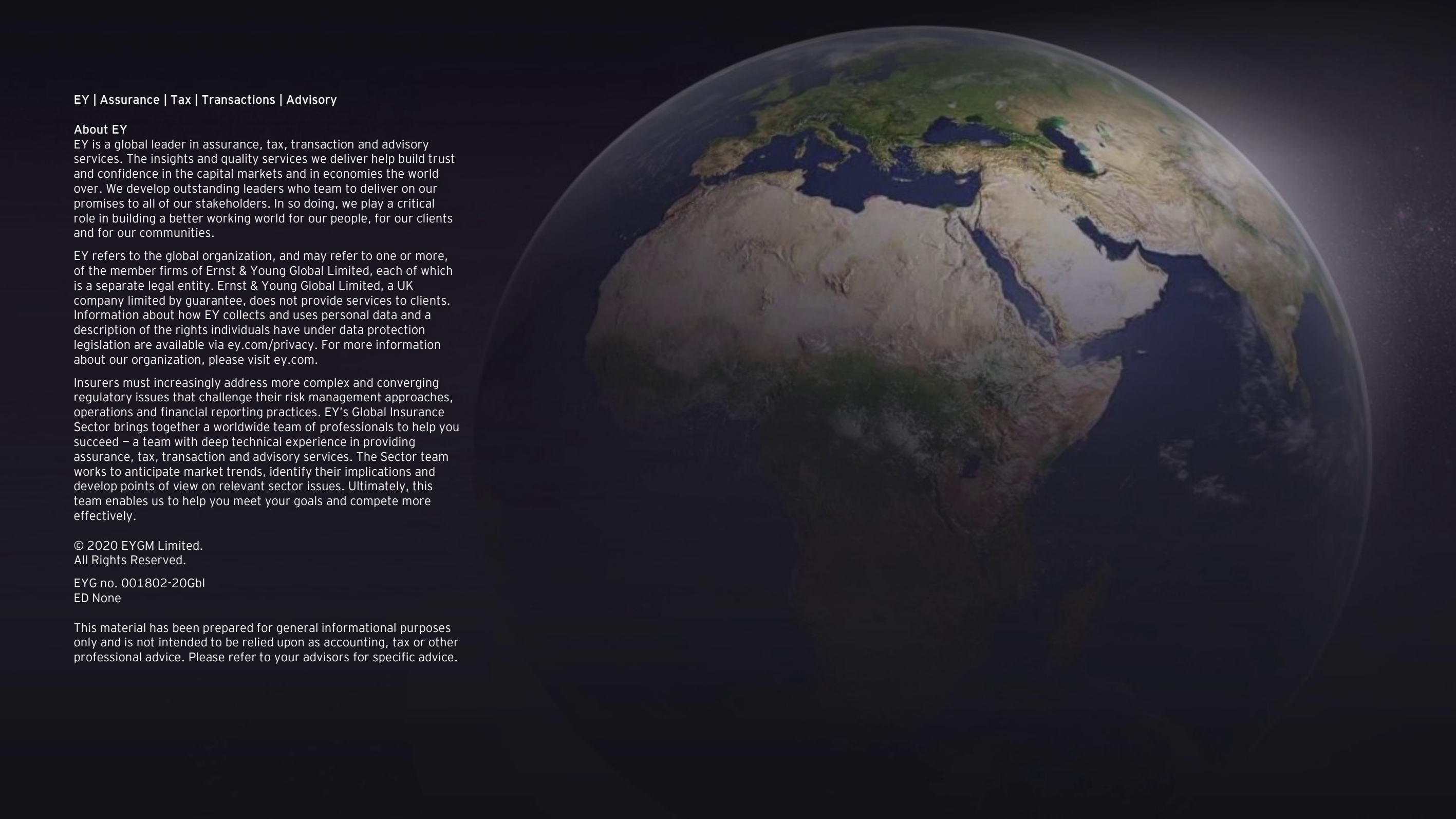
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