

# Newsflash

## COVID-19: Potential impacts on insurers

The emergence and subsequent spread of COVID-19, a new form of coronavirus, has had a global impact on public health, businesses and the economy.

On 29 December 2019, Chinese authorities identified a cluster of similar pneumonia cases with an unknown cause in Wuhan City, Hubei Province. A new strain of coronavirus was subsequently isolated from a patient on 7 January 2020. The World Health Organization (WHO) declared the emergence of the new coronavirus (2019-nCoV) a public health emergency of international concern on 30 January 2020. Global equity and high-yield credit markets have since fallen and the prices of the majority of developed market sovereign bonds have risen as investors exhibit 'flight to safety' tendencies in reaction to the uncertainty surrounding the long-term impact of the virus.

In this newsflash, we look at the impact on markets, the spread of the virus, and potential impacts on insurers – both immediate and long-term.

### Market impacts

The impact on stock markets was initially confined to China and Asian markets and the Chinese government took various measures to contain the outbreak, on 23 January introducing a quarantine in Wuhan and on 26 January extending the national New Year holiday. Despite China representing c19% of World GDP, global stock markets were initially resilient. However, with recent developments, the impacts are now more widely felt as shown in the table below.

Market Data	COB	Movement since		
		WHO declares global emergency	YE19	
	15/04/2020	30/01/2020	31/12/2019	
10yr UK Swap Rate	0.56%	↓	18 bps Decrease	↓ 46 bps Decrease
10yr UK Gilt Yield	0.30%	↓	25 bps Decrease	↓ 52 bps Decrease
FTSE 100	5,598	↓	-24.17%	↓ -25.78%
S&P 500	2,783	↓	-15.24%	↓ -13.85%
VIX (volatility) index	40.8	↑	163.65%	↑ 196.37%
GBP A-rated corporate bond spreads (10+ duration) bps	233.2	↑	58 bps Increase	↑ 61 bps Increase

Source: Bloomberg Data, Credit spreads based on iBoxx £ Corporates A 10+ index

### Have we seen this before?

Comparisons have been made between the new coronavirus and the SARS (severe acute respiratory syndrome) outbreak of 2003 which had a real, albeit short-term, impact on the economy. China's GDP growth rate slowed from 11% in the first quarter of 2003 to 9% in the second, with the largest impacts on tourism and transport. However, once SARS was contained, Chinese GDP growth quickly recovered.

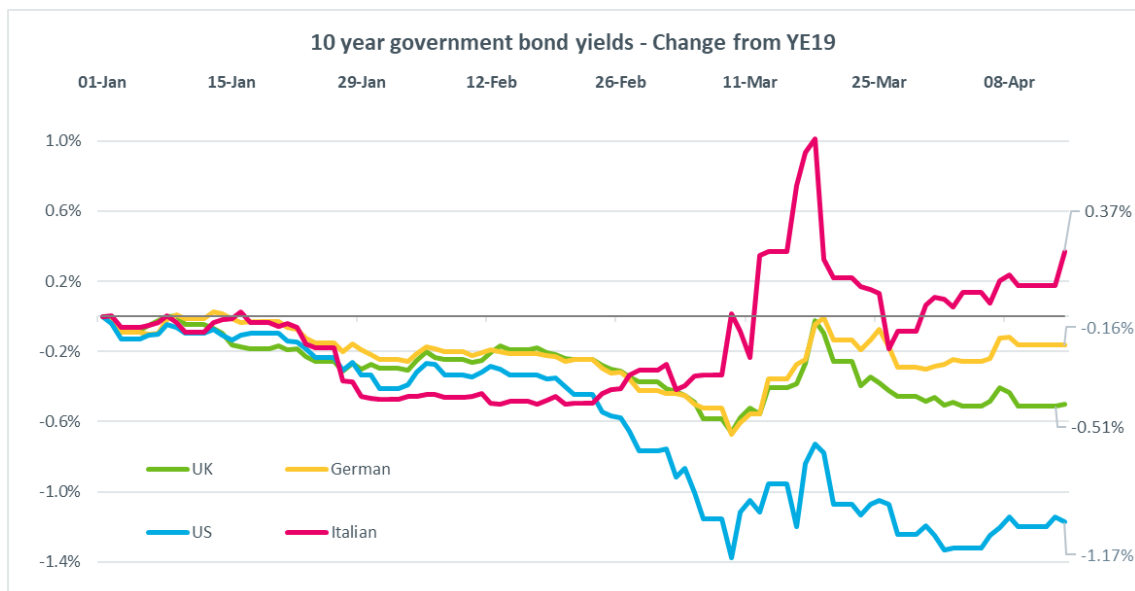
By comparison, the impacts of COVID-19 appear to be far more widespread and serious with the contagion count and impact on mortality experience both exceeding those reported during the SARS outbreak. At the time of writing (15 April 2020), WHO had [reported](#) that COVID-19 has been confirmed in 213 countries, infecting over 1.9 million and claiming more than 120,000 lives.

A further point of comparison<sup>1</sup> is the 1918 influenza, known as Spanish flu, which resulted in a mortality spike (most notably for those aged between 18 and 50) claiming the lives of c50 million people. Spanish flu affected up to a fifth of the global population. In 2006, the World Bank built a model to assess the economic impact of a flu-style epidemic similar to that of 1918. It assumes 35% of the global population will be infected with a 20% decline in tourism and services output. [According to the World Bank's report](#), a severe pandemic on the scale of Spanish flu could cause world output to shrink by as much as 5%.

## Recent market activity

The outbreak has now spread worldwide and on 11 March the WHO made the assessment that COVID-19 can be classified as a pandemic. Markets are reflecting this reassessment of the epidemic's future trajectory and the risks it poses as supply chains are disrupted, transport constrained and demand for services drops. Investors are now viewing COVID-19 as having a long-term impact on global demand. In response to this "sharp fall in trading conditions", the Bank of England has announced an emergency cut in interest rates and the UK Chancellor, Rishi Sunak, has unveiled a £30bn package to boost the economy and get the country through the outbreak.

It is a widely accepted phenomenon that in times of market uncertainty investors often exhibit 'flight to safety' tendencies. The market reaction supports this hypothesis: equity market prices have fallen, corporate bond spreads have widened and the yields on the majority of developed market sovereign bonds have fallen.



Source: Bloomberg Data

Calum Cooper, Partner at Hymans Robertson, wrote an article on the [impact of the coronavirus on DB scheme deficits](#). Below we look at the current situation for insurers.

## What does this all mean for insurers?

On 11 March the Bank of England published measures with the aim of helping UK businesses bridge across the economic disruption likely to be caused by COVID-19. As part of this the PRA has invited insurers to apply for recalculations of their Solvency II transitional measure on technical provisions (TMTP), stating that:

*"In response to the material fall in government bond yields in recent weeks, the PRC invites requests from insurance companies to use the flexibility in Solvency II regulations to recalculate the transitional measures that smooth the impact of market movements. This will support market functioning."*

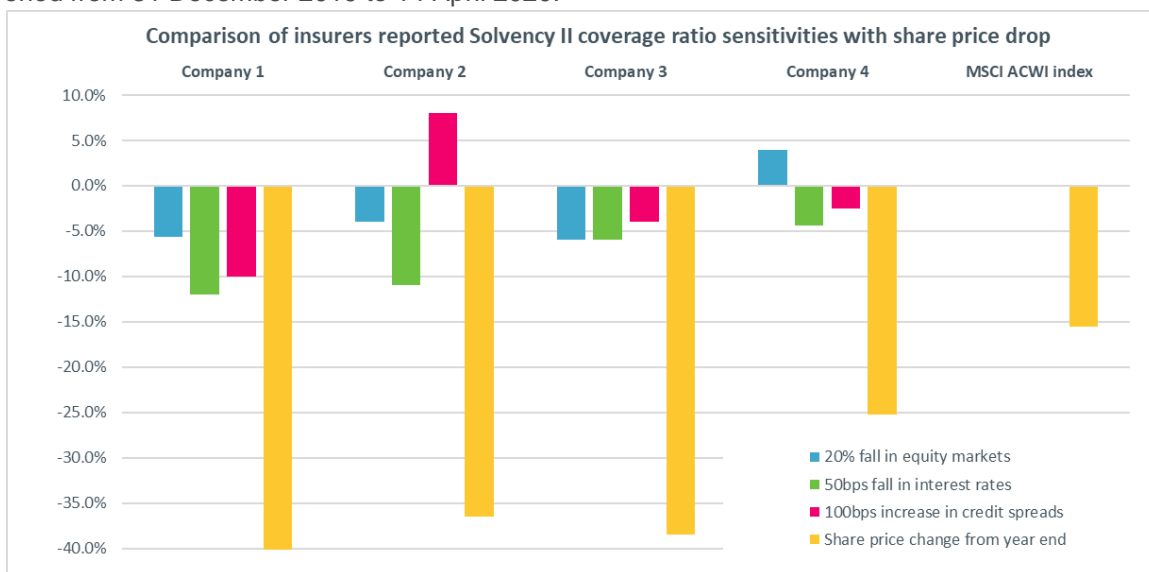
The TMTP should provide some relief to the pressure on insurers' balance sheets caused by the drop in government bond yields.

<sup>1</sup> We note that mortality experience during the 1918 flu is often used as one reference point for the calibration of insurers' mortality stresses.

Firms with equity market exposure, such as those with significant unit-linked and with-profits portfolios, are likely to have suffered a direct short-term hit to the value of funds under management. For unit-linked business this will result in a lower present value of future charges. Some with-profits firms may have started work to declare an emergency interim bonus in light of the market falls. We may see some firms taking additional measures to manage the risks associated with their claims processing. For example, where permitted under contract, some funds may seek to defer payment to allow time to liquidate underlying assets at an acceptable price.

UK annuity writers with large credit books will have seen the immediate impact of spread widening be absorbed by an increase in the matching adjustment. However, attention will now be turned to managing exposure to issuers and sectors most at risk of default or downgrade.

The impact of market movements on firms' solvency positions will depend on the nature of their business and the extent to which they have hedged against such movements. Below we show the sensitivity of four large UK insurers' Solvency II coverage ratios to stresses to equities, interest rates and credit spreads, as published in their year-end 2019 disclosures. We compare these with the change in the share prices of these same insurers over the period from 31 December 2019 to 14 April 2020.



Source: Company 2019 disclosures and website, MSCI website

Note: Some of the sensitivities have been scaled to give an estimate of the impact for a 20% fall in equity markets, a 50bps fall in interest rates and a 100bps increase in credit spreads. This scaling has been done to allow comparison between firms and assumes linearity of Solvency Coverage Ratio Impact.

We observe inconsistencies between insurers reported sensitivities to a change in market conditions and the market's views of the firms' value.

Recent events may also motivate firms to re-think their current approaches to assessing emerging risks and related operational risks in the context of their ORSA. With increasing trade, travel, population density, urbanisation and climate change epidemics like COVID-19 could increase in frequency.

- "The number of outbreaks, like the number of emerging infectious diseases, appears to be increasing with time in the human population both in total number and richness of causal diseases," [according to the authors of a 2014 study](#).
- Our increasingly interconnected society also accelerates the spread and magnifies the economic impact of epidemics. The World Economic Forum estimate that, in the coming decades, [flu pandemics will cause average annual losses of 0.7% of global GDP](#).

Such market commentary and incidences such as SARs and COVID-19 may lead some firms to revisit their assumptions about adverse scenarios and particularly the extent to which the impacts of demographic risk events and economic risks events may be correlated in adverse scenarios.

There is currently a lack of good quality data on epidemics, hence making them relatively difficult to model and predict. It is known that the impact of outbreaks is driven by a range of factors, including the type of virus, the location of initial outbreak and the government response to name a few, but more can be done to understand the relative importance of these factors. Could the insurance industry do more to support the collection of data, analysis and prediction of future outbreaks? For example, studying:

- The epidemiology of such diseases to better predict future outbreaks;
- The effectiveness of various government responses on containment; and
- The natural spread rate while new viruses go undetected in the initial stages of an outbreak given the increasing interconnectedness of countries/cities.

### How Hymans Robertson can support you

Hymans Robertson has a wealth of experience in risk & capital management, investment & ALM, products and longevity. We are well-placed to support your understanding and management of risk.

If you would like to speak to one of our specialists, please [get in touch](#).

In the meantime, we hope you and your loved ones stay healthy and safe.



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