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Coronavirus

FINANCIAL SERVICES

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National Association of Insurance Commissioners Special Session on COVID-19 Impact on U.S. Insurance Companies

OVERVIEW

As new cases of COVID-19 continue to surface in the United States at a rapid clip, clients have reached out asking a number of questions regarding COVID-19's current and anticipated impact on U.S. insurance companies. These questions include the following:

- How have COVID-19 and the resultant downtown in the public equity markets affected insurance companies?
- Do insurance companies hold sufficient liquid assets to pay claims and avoid insolvency?
- Are certain types of insurance companies or lines of business disproportionately affected by COVID-19?
- What impact does the low-interest environment have on insurance companies?

Regulators and other experts attending a special session of the Spring National Meeting of the National Association of Insurance Commissioners (NAIC) on COVID-19 weighed in on a number of these issues over the weekend. During this virtual meeting, Scott White, the Virginia Insurance Commissioner, Sean Kevelighan, CEO of Insurance Information Institute (III), and Michel Leonard, Vice President & Senior Economist of III, shared their insights on the potential impact of COVID-19 on the insurance industry.

VIRGINIA INSURANCE REGULATOR'S ASSESSMENT OF THE IMPACT OF COVID-19 ON LIFE INSURANCE COMPANIES AND THE U.S. INSURANCE INDUSTRY GENERALLY

Commissioner White began the virtual meeting by providing his assessment as to the likely impact of COVID-19 on insurance companies under two potential scenarios: a flattening of the curve (i.e., the number of COVID-19 cases rise more gradually) or a steep rise of COVID-19 infections over a short period of time. Under the former scenario, Commissioner White believes that very few, if any, insurance companies would be at risk of insolvency. To the extent the curve does not flatten in the near future, he believes that smaller healthcare insurers would become stretched and may become insolvent. Other key observations made by Commissioner White include the following:

- Based on modeling done by the Society of Actuaries and his general understanding of the current insurance industry, Virginia Commissioner White believes that the larger and more highly capitalized insurance companies would survive the current pandemic but the weakest carriers, regardless of lines of business (i.e., life, health or property/casualty), would struggle. He provided the caveat that his assessment only takes into account the effect of COVID-19 from a claims perspective (i.e., the number and severity of claims) and not from a financial markets standpoint.
- In the Virginia regulator's view, it is unlikely that insurance companies would encounter any issues in paying claims given that insurance companies are reserved to hold substantial amounts of cash and marketable securities for claims payments even if a Spanish Flu-like scenario unfolds (i.e., COVID-19 persists for a couple years and millions of Americans are hospitalized).
- Given recent and pending aggressive policy actions by Congress, the U.S. Department of Treasury and the Federal Reserve Board, from Commissioner White's perspective, the recent turmoil in financial markets would likely subside in the near future and assets backing reserves held by insurance companies would not be substantially impacted. Currently, life insurance companies hold 95% of these assets in bonds, most of which are investment grade and thereby would unlikely default during a downturn. Less than 5% of their assets are held in publicly traded stocks. Accordingly, it is unlikely that insurers would need to liquidate any depressed assets (i.e., equities) during the current downturn to pay claims.
- The current low-interest environment would most likely have a negative impact on insurance companies - it would reduce their earnings and, in Commissioner White's view, lead them to pursue investments in complex securities designed to generate stronger returns than [plain vanilla] bonds.

IMPACT OF COVID-19 ON THE PROPERTY AND CASUALTY INSURANCE INDUSTRY

Sean Kevelighan and Michel Leonard, members of the Insurance Information Institute (III), a business association focused on improving public understanding of insurance, gave the regulators a presentation on the impact of COVID-19 on the property and casualty insurance industry, as a whole, focusing on whether insurers providing certain types of insurance would be more adversely impacted by the pandemic. Some of the key takeaways from their presentation include the following:

- Property and casualty insurance companies are in a strong position to weather the current pandemic and to pay any covered claims.
- Cumulative policyholder surplus (assets less reserves and other liabilities) was more than $800 billion as of the third quarter of 2019. This sum is eight times the amount of U.S. property casualty claims payments for 2017 natural disasters. In the event that insurance companies experience a steep increase in losses beyond current reserve levels, the industry would have sufficient funds to handle the increase.
- Property and casualty insurance companies hold diversified, conservative investment portfolios - on average, 69% of their portfolios are held in bonds, 21% in equities and 13% in other investments. Most of these investments have low volatility and would be sufficient to satisfy policyholder claims.

- Property and casualty insurance companies are supported by a well-capitalized reinsurance market.
- Property and casualty insurance companies would not be significantly impacted by any increase in business interruption claims due to their strong fundamentals and the policy terms including long waiting periods, high deductibles/co-insurance, and requirements for direct property loss.
- In the unlikely scenario that there are insurance company insolvencies, existing property and casualty guaranty funds would step in and pay claims on the insurance company's behalf.
- Mr. Leonard also gave III's assessment of the impact of COVID-19 on different types of property and casualty insurance coverages:
  - Highest Impact – Worker's Compensation insurance, specifically insurance companies that provide coverage to hospitals, medical service companies, emergency medical technicians (EMTs), law enforcement, fire departments and first responders given that they are on the front lines of the pandemic and may be exposed to those with COVID-19.
  - Moderate Impact – Liability and D&O insurance. Liability exposure would arise from any failure to adequately follow and communicate public health guidelines. D&O exposure would arise from publicly traded companies' risk with respect to disclosure requirements on filings and financials.
  - Lowest impact – Property and Automobile insurance. Reductions in movements of goods and people are normally associated with lower economic activity.

CONCLUSION

As a result of the recent drop in the public equity markets and the tightening of the credit markets, it may be substantially more expensive and difficult for insurance companies to raise capital, whether through issuance or sale of company shares or through debt financing. Even for those insurance companies that are not facing a liquidity crunch, they will generate significantly less investment returns in the current ultra-low interest rate environment given that their investment portfolios consist mostly of bonds. To the extent the pandemic persists for an extended period of time, insurance companies could also face increased credit risk – certain U.S. companies (e.g., airlines, hotels, oil companies, etc.) may be unable to generate enough revenue to satisfy their debt obligations.

For investors in the life insurance industry, the near and intermediate term will be revealing as to whether the recent downturn in equity markets and the current interest rates will adversely affect life insurance company valuations and, if so, whether depressed valuations will diminish the inventory available for acquisitions or entice various types of investors to seek and acquire insurance companies or blocks of insurance business.

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